

**NEW ISSUE
BOOK-ENTRY ONLY**

RATINGS:
Fitch: AA
Moody's: Aa2
Standard & Poor's: AA+
(see "Ratings" herein)

In the opinion of Sidley Austin LLP, San Francisco, California, Bond Counsel, based on existing statutes, regulations, rulings and judicial decisions and assuming compliance with certain covenants in the documents pertaining to the Series 2011 Bonds and requirements of the Internal Revenue Code of 1986, as amended (the "Code"), as described herein, interest on the Series 2011 Bonds is not includable in the gross income of the owners of the Series 2011 Bonds for federal income tax purposes. In the further opinion of Bond Counsel, interest on the Series 2011 Bonds is not treated as an item of tax preference in calculating the federal alternative minimum taxable income of individuals and corporations. Interest on the Series 2011 Bonds, however, is included as an adjustment in the calculation of federal corporate alternative minimum taxable income and may therefore affect a corporation's alternative minimum tax liability. In the further opinion of Bond Counsel, interest on the Series 2011 Bonds is exempt from all taxation by the State of Hawaii or any county or other political subdivision thereof, except inheritance, transfer, and estate taxes and the franchise tax imposed on banks and other financial institutions pursuant to Chapter 241 of Title 14 of the Hawaii Revised Statutes. See "TAX MATTERS" herein.

\$117,365,000
STATE OF HAWAII
Highway Revenue Bonds

\$112,270,000
Series 2011 A

\$5,095,000
Series 2011 B

Dated: Date of Delivery

Due: as shown on inside cover

The State of Hawaii Highway Revenue Bonds, Series 2011 A and Series 2011 B (the "Series 2011 A Bonds" and "Series 2011 B Bonds," respectively, and together, the "Series 2011 Bonds"), are being issued (i) in the case of the Series 2011 A Bonds, to provide funds for certain highway capital improvement projects, (ii) in the case of the Series 2011 B Bonds, to refund certain outstanding Highway Revenue Bonds, (iii) to pay the costs of issuance of the Series 2011 Bonds, and (iv) to make a deposit to the Highway Senior Debt Service Reserve Subaccount (as defined herein), as necessary. See "PLAN OF FINANCE" and "ESTIMATED SOURCES AND USES OF THE PROCEEDS OF THE SERIES 2011 BONDS" herein. The Series 2011 Bonds are special limited obligations of the State of Hawaii (the "State"), payable solely from and secured solely by the Pledged Funds under the Certificate, consisting principally of highway fuel license taxes, vehicle registration fees, vehicle weight taxes and rental motor vehicle and tour vehicle surcharge taxes, as more fully described in this Official Statement.

The Series 2011 Bonds are issuable in fully registered form and when initially issued will be registered in the name of Cede & Co., as nominee of The Depository Trust Company ("DTC"), New York, New York. So long as DTC or its nominee is the registered owner of the Series 2011 Bonds, purchases of the Series 2011 Bonds will be made in book-entry form only, through brokers and dealers who are, or who act through, DTC participants; beneficial owners of the Series 2011 Bonds will not receive physical delivery of bond certificates; payment of the principal of and interest on the Series 2011 Bonds will be made directly to DTC or its nominee; and disbursement of such payments to DTC participants will be the responsibility of DTC and disbursement of such payments to the beneficial owners will be the responsibility of DTC participants (See "BOOK-ENTRY SYSTEM" herein). Purchases of the Series 2011 Bonds may be made in the denomination of \$5,000 or any integral multiple thereof.

Interest on the Series 2011 Bonds is payable on each January 1 and July 1 commencing July 1, 2012. The Series 2011 Bonds are subject to optional redemption prior to maturity as stated herein. See "THE SERIES 2011 BONDS – Redemption" herein.

The Series 2011 Bonds do not constitute a general or moral obligation of the State nor a charge upon the general fund of the State. The full faith and credit of the State are not pledged to the payment of the principal of or interest on the Series 2011 Bonds.

The Series 2011 Bonds are being issued pursuant to the Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Highway Revenue Bonds, dated as of August 1, 1993, as supplemented.

This cover page contains certain information for quick reference only. It is not a summary of this issue. Investors must read the entire Official Statement to obtain information essential to the making of an informed investment decision.

The Series 2011 Bonds are offered when, as and if issued by the State and received by the Underwriters, subject to prior sale or withdrawal or modification of the offer without notice, and to the approving legal opinion of Sidley Austin LLP, Bond Counsel. Certain legal matters will be passed upon for the Underwriters by their counsel, McCorriston Miller Mukai MacKinnon LLP. It is expected that the Series 2011 Bonds in definitive book-entry form will be available for delivery through the facilities of The Depository Trust Company in New York, New York, on or about December 15, 2011.

BAIRD

RBC CAPITAL MARKETS

Dated: November 30, 2011

MATURITY SCHEDULE

\$112,270,000 State of Hawaii Highway Revenue Bonds, Series 2011 A

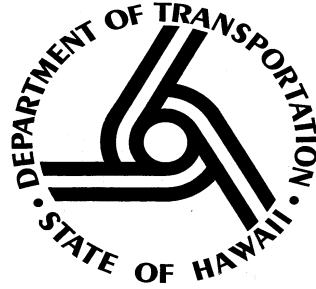
<u>Maturity Date (Jan. 1)</u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>Yield</u>	<u>CUSIP* (41981C)</u>	<u>Maturity Date (Jan. 1)</u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>Yield</u>	<u>CUSIP* (41981C)</u>
2013	\$1,000,000	0.75%	0.50%	JL5	2021	\$2,000,000	4.00%	2.45%	KM1
2013	2,690,000	2.00	0.50	KT6	2021	2,995,000	5.00	2.45	KX7
2014	3,985,000	3.00	0.71	JM3	2022	2,755,000	4.00	2.69	JV3
2015	100,000	1.00	1.00	JN1	2022	2,755,000	5.00	2.69	KN9
2015	2,005,000	4.00	0.95	KF6	2023	660,000	5.00	2.89**	KP4
2015	2,000,000	5.00	0.95	KU3	2024	1,500,000	4.00	3.09**	JW1
2016	2,145,000	4.00	1.19	JP6	2024	4,495,000	5.00	3.02**	KQ2
2016	2,145,000	5.00	1.19	KG4	2025	1,500,000	4.00	3.34**	JX9
2017	255,000	1.50	1.50	JQ4	2025	4,780,000	5.00	3.24**	KR0
2017	2,225,000	4.00	1.48	KH2	2026	1,500,000	4.00	3.46**	JY7
2017	2,000,000	5.00	1.48	KV1	2026	5,075,000	5.00	3.36**	KS8
2018	2,340,000	3.00	1.68	JR2	2027	6,890,000	5.00	3.47**	JZ4
2018	2,335,000	4.00	1.68	KJ8	2028	7,235,000	5.00	3.58**	KA7
2019	260,000	2.00	1.92	JS0	2029	7,600,000	5.00	3.68**	KB5
2019	2,575,000	4.00	1.92	KK5	2030	7,980,000	5.00	3.77**	KC3
2019	2,000,000	5.00	1.92	KW9	2031	8,375,000	5.00	3.85**	KD1
2020	2,525,000	4.00	2.21	JT8	2032	640,000	4.00	4.00	KE9
2020	2,520,000	5.00	2.21	KL3	2032	8,155,000	5.00	3.92**	KY5
2021	275,000	2.50	2.47	JU5					

\$5,095,000 State of Hawaii Highway Revenue Bonds, Series 2011 B

<u>Maturity Date (Jan. 1)</u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>Yield</u>	<u>CUSIP* (41981C)</u>
2023	\$5,095,000	4.00%	2.94%**	KZ2

* Copyright, American Bankers Association. CUSIP data provided by Standard & Poor's CUSIP Service Bureau, a division of The McGraw-Hill Companies, Inc. This data is not intended to create a database and does not serve in any way as a substitute for the CUSIP Service. CUSIP numbers are provided for convenience of reference only. Neither the State nor the Underwriters takes any responsibility for the accuracy of such numbers.

** Priced to call at par on January 1, 2022.



STATE OF HAWAII

Neil Abercrombie, Governor
Brian Schatz, Lieutenant Governor

DEPARTMENT OF TRANSPORTATION

Glenn Okimoto, Director

Deputy Director, Capital Improvement Projects
Deputy Director, Administration
Deputy Director, Airports Division
Deputy Director, Harbors Division
Interim Administrator, Highways Division
Administrator, Harbors Division

Jadine Y. Urasaki
Jade Butay
Ford N. Fuchigami
Randy Grune
Alvin Takeshita
Davis Yogi

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John B. Ray, Hawaii-Kamuela

SPECIAL SERVICES

Department of Budget and Finance of the State of Hawaii
Paying Agent and Registrar

Sidley Austin LLP
Bond Counsel

NO DEALER, BROKER, SALESPERSON OR OTHER PERSON HAS BEEN AUTHORIZED BY THE STATE OR THE UNDERWRITERS TO GIVE ANY INFORMATION OR TO MAKE ANY REPRESENTATIONS, OTHER THAN AS CONTAINED IN THIS OFFICIAL STATEMENT, AND IF GIVEN OR MADE, SUCH OTHER INFORMATION OR REPRESENTATIONS MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED BY THE STATE OR THE UNDERWRITERS. THIS OFFICIAL STATEMENT DOES NOT CONSTITUTE AN OFFER TO SELL OR THE SOLICITATION OF AN OFFER TO BUY THE SERIES 2011 BONDS, NOR SHALL THERE BE ANY SALE OF THE SERIES 2011 BONDS BY ANY PERSON, IN ANY JURISDICTION IN WHICH IT IS UNLAWFUL FOR SUCH PERSONS TO MAKE SUCH OFFER, SOLICITATION OR SALE.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS THAT STABILIZE OR MAINTAIN THE MARKET PRICE OF THE SERIES 2011 BONDS AT LEVELS ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZATION, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

NEITHER THE DELIVERY OF THIS OFFICIAL STATEMENT NOR ANY SALE MADE HEREUNDER SHALL, UNDER ANY CIRCUMSTANCES, CREATE ANY IMPLICATION THAT THERE HAS BEEN NO CHANGE IN THE AFFAIRS OF THE STATE SINCE THE DATE HEREOF.

THIS OFFICIAL STATEMENT IS NOT TO BE CONSTRUED AS A CONTRACT WITH THE PURCHASERS OF THE SERIES 2011 BONDS. THE INFORMATION AND EXPRESSIONS OF OPINION CONTAINED IN THIS OFFICIAL STATEMENT ARE SUBJECT TO CHANGE WITHOUT NOTICE. STATEMENTS CONTAINED HEREIN WHICH INVOLVE ESTIMATES, FORECASTS OR MATTERS OF OPINION, WHETHER OR NOT EXPRESSLY SO DESCRIBED HEREIN, ARE INTENDED SOLELY AS SUCH AND ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT OR REPRESENTATIONS THAT THE ESTIMATES WILL BE REALIZED.

THIS OFFICIAL STATEMENT HAS BEEN "DEEMED FINAL" AS OF ITS DATE BY THE STATE PURSUANT TO RULE 15c2-12 OF THE SECURITIES AND EXCHANGE COMMISSION PROMULGATED UNDER THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. THE STATE HAS ALSO UNDERTAKEN TO PROVIDE CONTINUING DISCLOSURE ON CERTAIN MATTERS, INCLUDING ANNUAL FINANCIAL INFORMATION AND SPECIFIC MATERIAL EVENTS, AS MORE FULLY DESCRIBED HEREIN. SEE "CONTINUING DISCLOSURE" HEREIN.

THE UNDERWRITERS HAVE PROVIDED THE FOLLOWING SENTENCE FOR INCLUSION IN THIS OFFICIAL STATEMENT: THE UNDERWRITERS HAVE REVIEWED THE INFORMATION IN THIS OFFICIAL STATEMENT IN ACCORDANCE WITH, AND AS PART OF, THEIR RESPONSIBILITIES TO INVESTORS UNDER THE FEDERAL SECURITIES LAWS AS APPLIED TO THE FACTS AND CIRCUMSTANCES OF THIS TRANSACTION, BUT THE UNDERWRITERS DO NOT GUARANTEE THE ACCURACY OR COMPLETENESS OF SUCH INFORMATION.

THE SERIES 2011 BONDS HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, IN RELIANCE UPON AN EXEMPTION CONTAINED IN SUCH ACT, NOR HAVE THEY BEEN REGISTERED UNDER THE SECURITIES LAWS OF ANY STATE.

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OFFICIAL STATEMENT

STATE OF HAWAII

\$117,365,000

Highway Revenue Bonds Series 2011 A and Series 2011 B

INTRODUCTION

This Official Statement, which includes the cover page and appendices (the “Official Statement”), provides information with respect to the issuance and sale by the State of Hawaii (the “State”) of \$117,365,000 principal amount of State of Hawaii Highway Revenue Bonds, Series 2011 A and Series 2011 B (the “Series 2011 A Bonds” and “Series 2011 B Bonds,” respectively, and together, the “Series 2011 Bonds”). Capitalized terms not otherwise defined in this Official Statement shall have the respective meanings given to such terms in Appendix A – “SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE – Definitions of Certain Terms.”

The State will issue the Series 2011 Bonds pursuant to the Constitution, the laws of the State and the Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Highway Revenue Bonds dated as of August 1, 1993, as heretofore supplemented and as further supplemented by a Ninth Supplemental Certificate of the Director of Transportation Authorizing State of Hawaii Highway Revenue Bonds, Series 2011 A and Series 2011 B, dated as of December 1, 2011 (as so supplemented, the “Certificate”). See “THE SERIES 2011 BONDS” for a description of the Series 2011 Bonds.

The State has issued nine series of its Highway Revenue Bonds under the Certificate, six of which remain outstanding on the date hereof in the following aggregate principal amounts: \$27,580,000 (Series 1998), \$5,400,000 (Series 2001), \$10,465,000 (Series 2003), \$46,675,000 (Series 2005A), \$112,155,000 (Series 2005B), and \$117,575,000 (Series 2008) (collectively, the “Outstanding Bonds”). Additional bonds and refunding bonds may subsequently be issued on a parity with the Series 2011 Bonds and the Outstanding Bonds (collectively with the Series 2011 Bonds and the Outstanding Bonds, the “Senior Bonds”), or may be issued subordinate in right of payment to the Series 2011 Bonds and other Senior Bonds (the “Subordinate Bonds”). Currently, there are no Subordinate Bonds outstanding. The Series 2011 Bonds and the Outstanding Bonds and any additional Senior Bonds and Subordinate Bonds are collectively referred to in this Official Statement as the “Bonds.”

The Series 2011 Bonds are being issued (i) to provide moneys, together with other available moneys of the State, to finance certain highway capital improvement projects, (ii) to refund certain Outstanding Bonds, as described in “PLAN OF FINANCE,” (iii) to pay the costs of issuance of the Series 2011 Bonds, and (iv) to make a deposit to the Highway Senior Debt Service Reserve Subaccount (as defined herein), as necessary. See “ESTIMATED SOURCES AND USES OF THE PROCEEDS OF THE SERIES 2011 BONDS.”

The Bonds are special limited obligations of the State, payable solely from and secured solely by Pledged Funds as provided under the Certificate, consisting of moneys held in the funds and accounts under the Certificate, revenues derived by the State from the ownership and operation of the statewide system of highways, streets and roads (the “State Highway System”) and receipts of Pledged User Taxes related thereto, consisting principally of the highway fuel license taxes, vehicle registration fees, the vehicle weight taxes, and the rental motor vehicle and tour vehicle surcharge taxes, as described in this Official Statement under “SECURITY FOR THE BONDS.” All Senior Bonds, including the Series 2011 Bonds, are and will be secured equally and ratably by the Pledged Funds. Receipts of the Pledged User Taxes are deposited into the State Highway Fund, a special fund created by State law in the State Treasury, for credit to the Highway Revenue Special Account created by the Certificate. The Series 2011 Bonds do not constitute a general or moral obligation of the State nor a charge upon the general fund of the State. The full faith and credit of the State are not pledged to the payment of or as security for the Series 2011 Bonds. See “SECURITY FOR THE BONDS” and “REVENUE SOURCES” for a description of the security for the Bonds and sources of Pledged Funds.

The State Highway System is owned, operated, maintained, and improved by the Department of Transportation of the State (the “Department”). The Department maintains an ongoing capital improvement program (the “Program”) to improve, renew and renovate the State Highway System. See “CAPITAL IMPROVEMENT PROGRAM” for a description of the Program and Appendix B – “ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES, THE STATE HIGHWAY SYSTEM AND THE DEPARTMENT OF TRANSPORTATION” for a description of the State Highway System.

Every other fiscal year, the Department prepares a program of proposed capital improvement projects to the State Highway System for approval of the Governor and the Legislature of the State. The Program is funded on a biennial basis through Legislative appropriations. In the first year of a biennium budget, the Department may revise the second year of that biennium budget for presentation to the Governor for approval and to the Legislature for subsequent authorization.

The cover page and this Introduction contain certain information for general reference only. They are not intended to be a summary of the Series 2011 Bonds. Investors are advised to read this entire Official Statement to obtain information essential to the making of an informed investment decision. This Official Statement contains descriptions of the Department and the Program, summaries of the Series 2011 Bonds, the security for the Bonds and certain provisions of the Certificate. All references to the Certificate and to the Series 2011 Bonds are qualified by the definitive forms of such Certificate and Series 2011 Bonds, copies of which may be obtained from the Department at 869 Punchbowl Street, 5th floor, Honolulu, Hawaii 96813. Any statement or information involving matters of opinion or estimates are represented as opinions or estimates made in good faith, but no assurance can be given that facts will materialize as so opined or estimated.

PLAN OF FINANCE

Capital Improvement Projects

A portion of the proceeds of the sale of the Series 2011 A Bonds will be used to finance certain highway capital improvement projects comprising portions of the statewide system of highways, streets and roads, including the potential projects identified in Appendix B – “ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES, THE STATE HIGHWAY SYSTEM AND THE DEPARTMENT OF TRANSPORTATION – THE DEPARTMENT OF TRANSPORTATION – Authorized Projects.”

Plan of Refunding

The Series 2011 B Bonds are being issued to refund the principal amount of certain Outstanding Bonds previously issued by the State under the Certificate, as identified in the table below (the “Refunded Bonds”).

Refunded Bonds

<u>Series</u>	<u>Maturity</u>	<u>Principal Amount</u>	<u>Redemption Date</u>	<u>Redemption Price</u>	<u>CUSIP</u> [†]
2001	July 1, 2022	\$5,400,000	Dec. 15, 2011	100%	41981CFC9

[†] Copyright, American Bankers Association. CUSIP data provided by Standard & Poor’s CUSIP Service Bureau, a division of The McGraw-Hill Companies, Inc. This data is not intended to create a database and does not serve in any way as a substitute for the CUSIP Service. CUSIP numbers are provided for convenience of reference only. Neither the State nor the Underwriters takes any responsibility for the accuracy of such numbers.

THE SERIES 2011 BONDS

General

The Series 2011 Bonds will be dated their date of delivery and will bear interest from such date at the rates per annum set forth on the inside cover page of this Official Statement, and will mature on January 1 in the years

and in the principal amounts set forth on the inside cover of this Official Statement. Interest will be payable on each January 1 and July 1, commencing July 1, 2012 (each an “Interest Payment Date”). Principal of, premium, if any, and interest on the Series 2011 Bonds will be payable in any coin or currency of the United States of America which at the time of payment is legal tender for public and private debts.

The Series 2011 Bonds, when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York (“DTC”). DTC will act as securities depository for the Series 2011 Bonds. Individual purchases of the Series 2011 Bonds will be made in book-entry form only (the “Book-Entry System”), in the principal amount of \$5,000 or integral multiples thereof. Purchasers will not receive certificates representing their interest in the Series 2011 Bonds. Principal of and interest on the Series 2011 Bonds will be paid by the Paying Agent for the Series 2011 Bonds to DTC, which will in turn remit such principal and interest to its Participants (as hereinafter defined), for subsequent distribution to the Beneficial Owners (as hereinafter defined) of the Series 2011 Bonds, as described herein. See “BOOK-ENTRY SYSTEM,” below.

If the Book-Entry System is discontinued for the Series 2011 Bonds, thereafter (i) principal of the Series 2011 Bonds will be payable upon presentation and surrender of the Series 2011 Bonds at the principal office of the Department of Budget and Finance of the State, as Paying Agent for the Series 2011 Bonds (together with any successor, the “Paying Agent”); and (ii) interest on each Series 2011 Bond will be paid on each Interest Payment Date by check mailed by the Paying Agent to the owner in whose name the Series 2011 Bond is registered upon the books of registry to be kept and maintained by the Department of Budget and Finance of the State, as registrar for the Series 2011 Bonds (the “Registrar”), as of the close of business on the 15th day of the calendar month (whether or not a business day) next preceding each Interest Payment Date at such owner’s address as shown on the Bond Register.

The Department, the Registrar, and the Paying Agent may deem and treat the person in whose name any Series 2011 Bond is registered upon the Bond Register (an “Owner” or “Holder”) as the absolute owner of such Bond for all purposes of the Certificate, including receiving payment of the principal of and interest due on the Series 2011 Bonds. So long as the Series 2011 Bonds are in the Book-Entry System, the registered owner of the Series 2011 Bonds in the Bond Register will be Cede & Co., and all such payments will be made to Cede & Co., as registered Owner.

Authority for Issuance

Article VII, Section 12 of the State Constitution and Part III, Chapter 39, Hawaii Revised Statutes (“HRS”), as amended (collectively the “General Revenue Bond Law”), permit the issuance of revenue bonds of the State payable from and secured by the Pledged Funds upon the approval of a majority of the members of each house of the Legislature and pursuant to a certificate of the Director of the Department (the “Director”), which becomes effective upon filing with the Director of Finance. The General Revenue Bond Law does not limit the aggregate principal amount of revenue bonds that may be issued, but does limit the maximum maturity of revenue bonds and also sets forth provisions for the sale, method of execution, and other details of all revenue bonds. The Legislature from time to time enacts laws (including the general appropriations acts) authorizing the issuance of revenue bonds (without fixing any particular details), defining the purposes for which the bonds are to be issued, and specifying the amount of the proceeds of such bonds which may be applied to such purposes. The Department, with the approval of the Governor, may issue refunding bonds without further authorization of the Legislature. Pursuant to the General Revenue Bond Law, the Director has issued the Certificate, which under State law constitutes the security document pursuant to which all Bonds are issued and secured. The Certificate provides the terms of the Bonds, including principal amounts, interest rates, maturities, redemption provisions and the covenants of the Department.

The Series 2011 Bonds are being issued pursuant to the Certificate and under the authority of and pursuant to the General Revenue Bond Law and Act 289, Session Laws of Hawaii (“SLH”) 1993, as amended by Act 252, SLH 1994, Act 218, SLH 1995, as amended by Act 287, SLH 1996, Act 328, SLH 1997, as amended by Act 116, SLH 1998 and Act 91, SLH 1999, as amended by Act 281, SLH 2000, Act 259, SLH 2001, as amended by Act 177, SLH 2002, Act 200, SLH 2003, as amended by Act 41, SLH 2004, Act 178, SLH 2005, as amended by Act 160, SLH 2006, and Act 213, SLH 2007, as amended by Act 158, SLH 2008, Act 162, SLH 2009, as amended by Act 180, SLH 2010, and Act 164, SLH 2011.

Redemption

Optional Redemption. The Series 2011 Bonds maturing on and after January 1, 2023 shall be subject to redemption at the option of the State prior to their stated maturity on and after January 1, 2022, as a whole or in part at any time, at a redemption price equal to 100% of the principal amount thereof, plus accrued interest to the date fixed for redemption. All remaining maturities of the Series 2011 Bonds are not subject to redemption prior to their stated maturities.

Notice of Redemption; Selection of Bonds. The Department shall cause notice of redemption to be mailed not less than 30 days prior to the redemption date, by registered or certified mail, to each registered holder of a Series 2011 Bond to be redeemed at its address appearing on the books of registry maintained by the Director of Finance. At the time notice of any optional redemption is given, the Department may also give notice to certain national information services selected by the Department and must also so notify certain bond information repositories. See “CONTINUING DISCLOSURE” and Appendix F.

Any notice of optional redemption may state that such redemption may be conditional upon the receipt by the Director of Finance or the Paying Agent for the Bonds proposed to be redeemed on the date fixed for redemption of moneys sufficient to pay in full the redemption price of the Bonds proposed to be redeemed. If the notice contains such condition, and moneys sufficient to pay in full the redemption price of the Bonds proposed to be redeemed shall not be received on or prior to the date fixed for redemption, such notice of redemption shall be null and void and of no force and effect, the State shall not redeem or be obligated to redeem any Bonds, and the State or the Paying Agent at the State’s direction shall give notice, in the same manner as notice of redemption is given, that moneys sufficient to pay in full the redemption price of the Bonds proposed to be redeemed were not received on or prior to the date fixed for redemption and such redemption did not occur. In the event of the failure to redeem, all Bonds surrendered for redemption shall be promptly returned to the registered holder by the State or the Paying Agent for the Bonds.

If less than all of the Series 2011 Bonds of a series are to be redeemed, the Bonds of such series to be redeemed shall be selected in such order of maturity as may be designated by the Department and by lot within each designated maturity. See “THE SERIES 2011 BONDS – Book-Entry System” for a discussion of the notice of redemption to be given to Beneficial Owners (as therein defined for the purposes of such discussion) and the manner of selection of the Series 2011 Bonds to be redeemed when the Book-Entry System for such Bonds is in effect.

Effect of Redemption. If a Series 2011 Bond is subject by its terms to redemption and has been duly called for redemption in accordance with the Certificate, and if sufficient moneys available for the payment of the redemption price and interest to accrue to the redemption date on such Series 2011 Bond are held for such purpose by the Director of Finance, such Series 2011 Bond so called for redemption shall become due and payable, and interest on such Bond shall cease to accrue, on the redemption date designated in such notice.

Upon surrender of any Series 2011 Bond to be redeemed in part only, the Department will execute and deliver to the holder a new Bond (or Bonds) of the applicable series and maturity representing the unredeemed principal amount of the Bond surrendered.

BOOK-ENTRY SYSTEM

Information concerning DTC and the Book-Entry System contained in this Official Statement has been obtained from DTC and other sources that the State and the Underwriters believe to be reliable, and is not guaranteed as to accuracy or completeness by, and is not to be construed as a representation by, the Underwriters or the State.

DTC will act as securities depository for the Series 2011 Bonds. The Series 2011 Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered bond certificate will be issued for each maturity of the Series 2011 Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world's largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC is rated AA+ by Standard & Poor's. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of Series 2011 Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2011 Bonds on DTC's records. The ownership interest of each actual purchaser of each Series 2011 Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series 2011 Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Series 2011 Bonds, except in the event that use of the book-entry system for the Series 2011 Bonds is discontinued.

To facilitate subsequent transfers, all Series 2011 Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Series 2011 Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2011 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2011 Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of the Series 2011 Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2011 Bonds, such as redemptions defaults, and proposed amendments to the Series 2011 Bond documents. For example, Beneficial Owners of the Series 2011 Bonds may wish to ascertain that the nominee holding the Series 2011 Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the Paying Agent and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Series 2011 Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the State as soon as possible after the record date. The Omnibus Proxy

assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Series 2011 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, distributions, and dividend payments on the Series 2011 Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Paying Agent, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC or its nominee, the Paying Agent, or the State, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the State or the Paying Agent, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the Series 2011 Bonds at any time by giving reasonable notice to the State or the Paying Agent. Under such circumstances, in the event that a successor depository is not obtained, Series 2011 Bond certificates are required to be printed and delivered.

The State may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Series 2011 Bond certificates will be printed and delivered to DTC.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the State believes to be reliable, but the State takes no responsibility for the accuracy thereof.

ESTIMATED SOURCES AND USES OF THE PROCEEDS OF THE SERIES 2011 BONDS

The following table shows the estimated sources and uses of moneys realized by the Department of the proceeds of the Series 2011 Bonds:

Sources:	Series 2011 A Bonds	Series 2011 B Bonds	Total
Bond Proceeds:			
Par Amount of Series 2011 Bonds	\$112,270,000.00	\$5,095,000.00	\$117,365,000.00
Original Issue Premium	<u>13,152,124.20</u>	<u>466,702.00</u>	<u>13,618,826.20</u>
TOTAL SOURCES OF FUNDS	<u>\$125,422,124.20</u>	<u>\$5,561,702.00</u>	<u>\$130,983,826.20</u>
Uses:			
Deposit to Highway Bond Proceeds Account*	\$120,000,000.00	\$ 0.00	\$120,000,000.00
Refunding of Refunded Bonds	0.00	5,523,000.00	5,523,000.00
Deposit to Debt Service Reserve Subaccount	4,615,550.00	0.00	4,615,550.00
Costs of Issuance**	<u>806,574.20</u>	<u>38,702.00</u>	<u>845,276.20</u>
TOTAL USES OF FUNDS	<u>\$125,422,124.20</u>	<u>\$5,561,702.00</u>	<u>\$130,983,826.20</u>

* To be applied for capital project purposes.

** Includes Underwriters' discount.

SECURITY FOR THE BONDS

General

The Bonds, including the Series 2011 Bonds, are special limited obligations of the State, and will be payable solely from and secured solely by the Pledged Funds. The Series 2011 Bonds, the Outstanding Bonds and any Additional Senior Bonds that may subsequently be issued under the Certificate are equally and ratably secured by a lien and charge on the Pledged Funds prior and paramount to the lien thereon of any other bonds.

“Pledged Funds” is defined in the Certificate to include the Revenues and the monies held in the Highway Revenue Special Account created in the Certificate and the Highway Bond Proceeds Account in the State Bond Fund. “Revenues” is defined to include the following when deposited in the State Highway Fund: Pledged User Taxes, certain revenues derived from the ownership or operation of, or disposition of properties constituting part of, the State Highway System, and certain investment earnings. “Pledged User Taxes” is defined to include the receipts of the highway fuel license taxes, vehicle registration fees, the vehicle weight taxes, and the rental motor vehicle and tour vehicle surcharge taxes. See “REVENUE SOURCES” below.

The Bonds do not constitute general or moral obligations of the State nor a charge upon the general fund of the State. The full faith and credit of the State are not pledged to the payment of the principal of or interest on the Bonds. The real property and improvements comprising the State Highway System have not been pledged or mortgaged to secure payment of the Bonds.

State law creates a special fund in the Treasury of the State designated as the State Highway Fund. The Certificate creates the Highway Revenue Special Account in the State Highway Fund and requires that the Highway Revenue Special Account be continued as long as any Bonds remain outstanding and provides that all Revenues will be deposited in the State Highway Fund for credit to the Highway Revenue Special Account. The Certificate further provides that amounts deposited in the Highway Revenue Special Account will be used in the order of priority established by the Certificate. Payment of principal of and interest on the Senior Bonds is the first priority and charge against the Highway Revenue Special Account. See “Funds and Accounts and Application of Revenues” below.

In the event of a default, the Holders of at least 25% in principal amount of the Senior Bonds then outstanding and the Holders of at least 25% in principal amount of the Subordinate Bonds then outstanding may declare an immediate acceleration of maturities by written notice to the Department, which notice shall also be filed with the Director of Finance of the State.

Under the doctrine of sovereign immunity, a state of the Union (including the State) cannot be sued by its own citizens. Under the United States Constitution, a state (including the State) cannot be sued by citizens of another state of the Union or by citizens or subjects of any foreign state. A state (including the State) may waive its immunity and consent to a suit against itself. The State has waived by statute its immunity from contractual claims. However, such waiver and consent may subsequently be withdrawn by the State. Such immunity from and constitutional prohibition against suits against a state extends to officers of a state acting in their official capacity.

Therefore, there can be no assurance that in the event the State fails to make timely payment of principal of or interest on the Bonds, a right of action would lie against the State or State officials to enforce such payment.

The State has never defaulted in the payment of either principal of or interest on any indebtedness.

Pledge of Revenues

Under the Certificate, the State and the Department pledge and grant a lien on the Pledged Funds to secure the Senior Bonds, which pledge and lien are superior and prior to the pledge of and lien upon the Pledged Funds in respect of the Subordinate Bonds; and pledge and grant a lien on the Pledged Funds to secure the Subordinate Bonds, which pledge and lien are inferior and subordinate to the pledge of and lien upon the Pledged Funds in respect of the Senior Bonds. The Certificate provides that the lien on the Pledged Funds to secure the Bonds is a

prior and paramount lien, subject only to the provisions of the Certificate permitting the application of such funds for the purposes and on the terms and conditions thereof.

The Certificate further provides that the moneys in the State Highway Fund shall, until used, applied and disbursed in accordance with the provisions of the Certificate, be held in trust: (1) for the equal benefit and security of the Holders of the Senior Bonds; and (2) subject to the prior and senior rights, benefits and security of the Holders of the Senior Bonds, for the equal benefit and security of the Holders of the Subordinate Bonds. Subject to the provisions of the Certificate concerning application of amounts on deposit in the subaccount relating to the Senior Bonds, all Senior Bonds have a prior and paramount lien on the Revenues paid into the Highway Revenue Special Account for credit to such subaccount and the investments in which such Revenues may be invested, over and ahead of all Subordinate Bonds and all bonds, notes or other evidences of indebtedness which may subsequently be issued. Subject to the prior and paramount lien provided in respect of the Senior Bonds and further subject to the provisions of the Certificate concerning application of amounts on deposit in the subaccount relating to the Subordinate Bonds, all Subordinate Bonds have a prior and paramount lien on the Revenues paid into the Highway Revenue Special Account for credit to such subaccount and the investments in which such Revenues may be invested, over and ahead of all bonds, notes or other evidences of indebtedness which may subsequently be issued.

Under the General Revenue Bond Law, the Department is obligated to impose, prescribe and collect rates, rents, fees, or charges for the use and services of, and the facilities and commodities furnished by, the State Highway System which, together with the proceeds of the Pledged User Taxes derived from the State Highway System, are at least sufficient: (1) to make the required payments of principal and interest on all Bonds, including reserves therefor; (2) to pay the costs of operation, maintenance and repair of the State Highway System, including reserves therefor; and (3) to carry out the covenants of the Certificate.

The State has considered but does not presently anticipate imposing any tolls, rates, rentals, fees or charges for the use and services provided by the State Highway System and, as indicated, expects that the principal source of payment of the Bonds will derive from the Pledged User Taxes imposed pursuant to law.

The State Constitution defines a “user tax” as a tax on goods or services or on the consumption thereof, the receipts of which are substantially derived from consumption, use or sale of goods and services in the utilization of the functions or services furnished by a public undertaking (an “Undertaking”), improvement or system. The specific acts of the Legislature authorizing Highway Revenue Bonds direct that they shall be payable from and secured by the revenues derived from highways and related facilities under the ownership of the State or operated and managed by the Department comprising the State Highway System, and from the highway fuel license taxes, vehicle registration fees, the vehicle weight tax, and the rental motor vehicle and tour vehicle surcharge taxes levied and paid pursuant to Sections 243-4, 248-8, 249-31, 249-33, and 251-2, HRS, and federal moneys received by the State or any department thereof which are available to pay principal of and interest on indebtedness of the State, and other user taxes, fees or charges currently or hereafter derived from or arising through the ownership, operation, and management of highways and related facilities and the furnishing and supplying of the services thereof. Each of the aforesaid taxes, charges and fees constitutes a “user tax” within the meaning of the State Constitution.

Under the General Revenue Bond Law, the Legislature has covenanted, pledged and obligated the Legislature, whenever the Legislature shall have authorized the issuance of bonds for an Undertaking such as the State Highway System, payable from and secured by the user taxes derived with respect to such Undertaking, or by both revenues and user taxes, or by any combination of both, to impose or continue to impose user taxes with respect to such Undertaking in amounts at least sufficient, together with the revenue of the Undertaking, to make the payments described above. These provisions would not prohibit the Legislature from changing the rate of existing Pledged User Taxes or other user taxes or fees or from deleting some or all of existing Pledged User Taxes or other user taxes or fees and substituting other or different user taxes or fees.

There is no requirement under the Certificate or the General Revenue Bond Law that the Legislature levy and deposit Pledged User Taxes into the State Highway Fund in excess of the amount necessary to make the deposits described in paragraphs FIRST through FIFTH under “Funds and Accounts and Application of Revenues” below.

Highway Senior Debt Service Reserve Subaccount

In order to provide a reserve for the payment of the principal of and interest on the Senior Bonds, the Certificate creates a Highway Senior Debt Service Reserve Subaccount in the Highway Revenue Special Account. The Certificate requires that moneys on deposit in the Highway Senior Debt Service Reserve Subaccount shall be maintained in an amount at least equal to one-half (1/2) of the maximum Aggregate Bond Service for the Senior Bonds at the time outstanding for any Bond Year (the "Reserve Requirement"), beginning with the Bond Year in which such determination is made. In lieu of the deposit of moneys to the Highway Senior Debt Service Reserve Subaccount, the Certificate allows the Department to credit one or more Support Facilities in an amount equal to the difference between the Reserve Requirement and the aggregate of (1) moneys already deposited in such Subaccount and (2) amounts available to be drawn under any Support Facility already credited to such Subaccount. See "Highway Senior Debt Service Reserve Subaccount" and definitions of Aggregate Bond Service, Bond Year and Support Facility in Appendix A – "SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE."

At the time of the delivery of the Series 2011 Bonds, the Reserve Requirement will be satisfied by depositing to the Highway Senior Debt Service Reserve Subaccount a portion of the proceeds from the sale of the Series 2011 A Bonds.

Funds and Accounts and Application of Revenues

The Certificate creates the Highway Revenue Special Account, comprised of the subaccounts listed below, within the State Highway Fund and provides that, so long as any Bonds are Outstanding: (1) the State Highway Fund and the Highway Revenue Special Account shall both be continued; and (2) all Revenues deposited in the State Highway Fund shall be credited to the Highway Revenue Special Account. Revenues from specified sources are deposited into the State Highway Fund. See "REVENUE SOURCES" below. Moneys that are paid into and are on deposit in the State Highway Fund constitute the Revenues that are pledged to the payment of the Bonds. Revenues credited or to be credited to the Highway Revenue Special Account are required to be applied and used in the following order of priority:

FIRST: For further credit to the following subaccounts in the following order of priority in the amounts required pursuant to the provisions of the Certificate:

- (a) Highway Senior Interest Subaccount;
- (b) Highway Senior Principal Subaccount; and
- (c) Highway Senior Debt Service Reserve Subaccount;

SECOND: For further credit to the following subaccounts in the following order of priority in the amounts required pursuant to the provisions of the Certificate:

- (d) Highway Subordinate Interest Subaccount;
- (e) Highway Subordinate Principal Subaccount; and
- (f) Highway Subordinate Debt Service Reserve Subaccount;

THIRD: For payment of Operation and Maintenance Expenses of the State Highway System;

FOURTH: For payment of the costs of acquisition, construction, addition, expansion, improvement, renewal, replacement, reconstruction, engineering, investigation and planning for the State Highway System;

FIFTH: To reimburse the general fund of the State for reimbursable general obligation bonds of the State;

SIXTH: All or any portion of available moneys credited to the Highway Revenue Special Account, after satisfying the requirements of priority items FIRST through FIFTH above, determined in conformance with law by the Director of Transportation to be in excess of 135% of the requirements for the ensuing 12 months for the Highway Revenue Special Account, or such other percentage as may be authorized by law, may be transferred from the Highway Revenue Special Account as permitted by and in accordance with State law; and

SEVENTH: To provide funds for other special reserve funds and other special funds as may be created by law.

Additional Bonds and Refunding Bonds

The Certificate permits the issuance of Additional Bonds payable from and secured by Pledged Funds on a parity with the Series 2011 Bonds, the Outstanding Bonds and other Senior Bonds, or the issuance of Additional Bonds which are Subordinate Bonds, for the purpose of paying or reimbursing the cost of acquisition or construction of properties to constitute part of the State Highway System or the making of additions to, expansions of, improvements of, renewals of or reconstructions of the State Highway System. Additional Bonds which are Senior Bonds must be fixed rate bonds. Additional Bonds which are Subordinate Bonds may be fixed rate bonds or variable rate bonds. The conditions for issuance of Additional Bonds include, among other things, that the Director certify that:

(1) no default in the payment of any Bond has occurred and is continuing; no deficiency exists in the State Highway Fund or the Highway Revenue Special Account; and there does not exist any Event of Default under the Certificate or a condition which upon the passage of time would constitute such an Event of Default;

(2) upon delivery of such Bonds, there shall be credited to the Highway Revenue Special Account for credit to the Highway Senior Debt Service Reserve Subaccount and the Highway Subordinate Debt Service Reserve Subaccount an amount equal to, in each case, the Reserve Requirement; provided that such requirement may be satisfied by a deposit of proceeds of such Bonds or a Support Facility; and

(3) in the case of Additional Bonds, the Revenues for any twelve consecutive calendar months out of the last eighteen consecutive calendar months immediately preceding the date of issuance of such Bonds shall be at least equal to: (a) in the case of Senior Bonds proposed to be issued, two times maximum Aggregate Bond Service for any future Fiscal Year on all Senior Bonds to be Outstanding after the issuance of such Additional Senior Bonds; and (b) in the case of Subordinate Bonds proposed to be issued, 1.30 times maximum Aggregate Bond Service for any future Fiscal Year on all Bonds to be Outstanding after the issuance of such Additional Subordinate Bonds.

The Certificate permits the issuance of Refunding Bonds payable from and secured by Pledged Funds on a parity with the Series 2011 Bonds and other Senior Bonds, or Refunding Bonds which are Subordinate Bonds, for the purpose of refunding any then outstanding Bonds, so long as the State has satisfied the requirement set forth in the first and second subparagraphs described above and without satisfying any financial tests. See Appendix A – “SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE – Conditions Precedent to Issuance of Additional Bonds and Refunding Bonds.”

The Certificate permits the issuance of other bonds or obligations payable from the Revenues subordinate and inferior to the payment of the Bonds from the Revenues.

REVENUE SOURCES

State Highway Fund

The State imposes taxes, fees and charges relating to the operation and use of motor vehicles on the public highways of the State. These funds are deposited into the State Highway Fund established under Section 248-8, HRS. Moneys deposited in the State Highway Fund are used for acquisition, planning, design, construction, operation, repair and maintenance of the State Highway System.

The current taxes, fees and charges deposited to the State Highway Fund consist of: (1) the highway fuel license taxes; (2) vehicle registration fees; (3) the vehicle weight tax; and (4) the rental motor vehicle and tour vehicle surcharge taxes. Together, these taxes, fees and charges accounted for most of the receipts of the State Highway Fund in the Fiscal Year ended June 30, 2011. See “Historical Revenues” below. Other sources of Revenues include interest earnings on moneys previously credited to the State Highway Fund, vehicle weight tax penalties, certain rental income from State Highway System properties, passenger motor vehicle inspection charges,

overweight permits, sales of surplus lands, commercial license fees and other miscellaneous Revenues. There are no toll roads or bridges in the State. The primary sources of Revenues are further described below.

Sources of Revenues and Pledged User Taxes

The following is a summary of the sources of Revenues that are deposited to the State Highway Fund. This summary does not purport to be a complete description of each of these Revenue sources and accordingly is qualified by reference to the Hawaii Revised Statutes regarding sources of Revenues. The Legislature has altered and may in the future alter the statutes governing these Revenue sources, the rates of the Pledged User Taxes and their allocation.

Highway Fuel License Taxes. Highway fuel license taxes consist of license taxes on fuel sold to motor vehicle operators pursuant to Chapter 243, HRS. The distributor of motor vehicle fuel pays the fuel license tax for liquid fuel produced or imported by the distributor to be sold or used by the distributor. Highway fuel license taxes are assessed at a rate of \$0.17 per gallon of gasoline and diesel oil (highway use), \$0.52 per gallon of liquid petroleum gas (highway use), and \$0.02 per gallon of gasoline, diesel oil and liquid petroleum gas (non highway use). The highway fuel license taxes are collected by the Department of Taxation, which then transfers the receipts to the State Highway Fund. The counties have a similar tax that is not included in the State's fuel license tax rate, as described in Appendix B – "ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES, THE STATE HIGHWAY SYSTEM AND THE DEPARTMENT OF TRANSPORTATION." Receipts of aviation fuel taxes and taxes collected with respect to liquid fuel sold for use in small boats are transferred to the Airport Revenue Fund and the Boating Special Fund, respectively, and not to the State Highway Fund.

Vehicle Registration Fees. Section 249-31, HRS, requires all vehicles, including motor vehicles, to be registered annually with one of the four counties of the State. Effective July 1, 2011, vehicle owners must pay a State registration fee of \$45 for each vehicle, an increase of \$20 per vehicle from the prior rate pursuant to Act 162, SLH 2011. From each annual motor vehicle registration fee, \$40 is deposited into the State Highway Fund and \$5 into the emergency medical services special fund. The four counties each collect the vehicle registration fee along with their respective county registration fees and transfer the State's vehicle registration fee to the State Highway Fund. See Appendix B – "ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES, THE STATE HIGHWAY SYSTEM AND THE DEPARTMENT OF TRANSPORTATION."

Vehicle Weight Taxes. All vehicles, including motor vehicles, are assessed an annual State vehicle weight tax pursuant to Section 249-33, HRS. Effective July 1, 2011, the tax rate is \$0.0175 per pound for vehicles weighing less than 4,000 pounds, \$0.02 per pound for vehicles weighing between 4,001 and 7,000 pounds, and \$0.0225 per pound for vehicles weighing between 7,001 and 10,000 pounds, an increase of \$0.01 per pound in each weight class from the prior rate pursuant to Act 86, SLH 2011. Also effective July 1, 2011, vehicles weighing over 10,000 pounds are taxed a flat rate of \$300 per vehicle, an increase of \$150 per vehicle from the prior rate. The four counties each collect the vehicle weight tax along with their respective county vehicle taxes and transfer the State's vehicle weight tax to the State Highway Fund. See Appendix B – "ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES, THE STATE HIGHWAY SYSTEM AND THE DEPARTMENT OF TRANSPORTATION."

Rental Motor Vehicle and Tour Vehicle Surcharge Taxes. Chapter 251, HRS, imposes a surcharge tax on all rental motor vehicles and tour vehicles. The rental motor vehicle surcharge tax is imposed on the owner of the rental company when a rental motor vehicle is rented or leased. The currently effective surcharge tax is \$3 per day or any portion of the day. This surcharge was scheduled to sunset on August 1, 2011, but was continued indefinitely pursuant to Act 104, SLH 2011.

The tour vehicle surcharge tax is imposed on the tour vehicle operator. The surcharge tax is \$15 per month for each tour vehicle with eight to twenty-five passenger seats that is used or partially used during the month. The surcharge tax is \$65 per month for each tour vehicle with more than twenty-five passenger seats that is used or partially used during the month.

All rental and tour companies must register with the State. The registration fee is a one-time \$20 fee.

Interest Earnings. Interest income is derived from the investment of moneys on deposit in the State Highway Fund.

Historical Revenues

The following table sets forth the sources of Revenues which were deposited into the State Highway Fund for each of the last ten fiscal years ended June 30, 2011.

Sources of Revenue Deposited in the State Highway Fund (in thousands)

Fiscal Year	Fuel Taxes	Pledged User Taxes					Total Revenues
		Registration Fees	Weight Taxes	Rental/Tour Vehicle Surcharge	Interest	Misc.*	
2002	\$73,046	\$17,461	\$25,444	\$36,054	\$11,453	\$25,769	\$189,227
2003	75,506	19,037	28,184	39,472	11,952	10,820	184,971
2004	79,607	19,174	27,393	41,414	8,569	9,684	185,841
2005	80,913	20,238	30,828	43,950	8,781	5,728	190,438
2006	82,853	20,766	30,740	50,582	14,166	5,180	204,287
2007	85,618	20,765	33,309	46,989	16,204	8,104	210,989
2008	87,885	21,033	33,549	49,196	14,316	5,876	211,855
2009	86,151	20,788	33,407	39,751	6,165	3,236	189,498
2010	81,027	20,577	32,937	40,401	4,891	4,815	184,648
2011**	89,349	20,841	33,423	43,892	4,004	5,621	197,130

* Miscellaneous Revenues include vehicle weight tax penalties, periodic motor vehicle inspection charges, and rents from State Highway System properties, commercial license fees, and other miscellaneous Revenues. For 2002, the Department of Transportation received \$22,506,672 for a gasoline litigation settlement of which \$22,000,000 was transferred to the State general fund. For 2003, \$2,500,000 was received for the sale of certain property.

** Unaudited.

Source: Department of Transportation.

The rate of taxation on fuel and the registration fee and weight tax on motor vehicles changed and increased significantly between 1975 and 2011. Highway fuel license taxes increased from \$0.085 per gallon of gasoline and diesel oil and \$0.060 per gallon of liquid petroleum gas in 1975, to \$0.110 per gallon of gasoline and diesel oil and \$0.080 per gallon of liquid petroleum gas in 1985, to \$0.160 per gallon of gasoline and diesel oil and \$0.110 per gallon of liquid petroleum gas in 1991, to the present rate of \$0.170 per gallon of gasoline and diesel oil on July 1, 2007. The liquid petroleum gas was adjusted to \$0.053 per gallon in 2002 to the present rate of \$0.052 per gallon of liquid petroleum gas on July 1, 2007.

The State vehicle registration fee increased from \$25 per vehicle in 2004 to \$45 per vehicle in 2011. Vehicle weight taxes increased from a minimum rate of \$0.0075 per pound to \$0.0175 per pound and a maximum charge of \$150 per vehicle to \$300 per vehicle between 1991 and 2011. The increase in vehicle registration fees and weight taxes which became effective July 1, 2011, is expected to result in a net increase in Revenues of approximately \$20.3 million and \$32.9 million, respectively. The full impact of this increase in Revenues is not expected to appear in the State Highway Fund until Fiscal Year 2013 due to delays in the implementation and collection of the fees and taxes by the counties.

See "DEBT SERVICE COVERAGE" for a discussion of projected Revenues.

THE DEPARTMENT OF TRANSPORTATION

Department Organization

The Department is one of 18 principal executive departments of the State. Chapter 26, HRS, empowers the Department to establish, maintain and operate the transportation facilities of the State, including highways, airports, harbors and such other transportation facilities. The Department's activities are carried out through three primary operating divisions: Airports, Harbors and Highways. The Department's Airports Division has general responsibility to construct, operate and maintain the Airports system. The Harbors Division has general responsibility to construct, operate and maintain the Harbors system.

Through the Highways Division (the "Highways Division"), the Department has general supervision of the management and maintenance of the State Highway System and the location, design and construction of new highways and facilities. The Highways Division provides supervision to assure completion of State highway contracts in accordance with plans and specifications.

The Department also has administrative offices which are responsible for Department-wide administrative functions and multi-modal statewide transportation planning. See Appendix B – "ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES, THE STATE HIGHWAY SYSTEM AND THE DEPARTMENT OF TRANSPORTATION" for additional information regarding the Department.

Department Management

The Department is headed by the Director, a single executive appointed by the Governor and confirmed by the State Senate. The Governor also appoints, without State Senate confirmation, four Deputy Directors of Transportation. The Director and Deputy Directors of Transportation serve four-year terms coterminous with the Governor's term.

Chapter 26, HRS, establishes the Commission on Transportation which sits in an advisory capacity to the Director on matters within the jurisdiction of the Department. The Commission on Transportation consists of at least one member from each of the four counties of the State.

The Highways Division is managed by the Highways Division Administrator. Each of the major islands is managed by a district manager with the exception of Maui District which includes the islands of Maui, Molokai and Lanai. The Staff Services Office, headed by the Administrative Services Officer, is responsible for personnel, budget, procurement, financial management and method, standards and evaluation functions of the Highways Division. Other major functional operations within the Highways Division include the Motor Vehicle Safety Office, Planning Branch, Design Branch, Materials Testing and Research Branch, Construction and Maintenance Branch, Traffic Branch and Rights of Way Branch.

Management Personnel

The following are the senior executives of the Department responsible for the management of the State Highway System:

Glenn Okimoto, Ph.D, Director, has served as Director of the Department since January 2011. He formerly served as the State Comptroller, Administrator for the Airports Division, Administrator for the Harbors Division, and Deputy Director for Administration division of the State of Hawaii Department of Transportation. He also served three years as the Budget Director for the University of Hawaii System just prior to his appointment as Director. He received his Bachelor, Master of Science, and Doctor of Philosophy degrees in Agricultural and Resource Economics from the University of Hawaii at Manoa.

Jadine Y. Urasaki, P.E., LEED AP, Deputy Director, assumed her present position in January 2011. She is responsible for the Planning, Programming, Budgeting, Capitol Improvement and Special Maintenance Programs for the Airports, Harbors and Highways Divisions. Prior to assuming this position, she was the Public

Works Manager responsible for all construction for the Department of Education (2008-2011), was the Acting Planning, Programming and Budget Manager (2004-2008) for Administration Division of the Department of Transportation, was the Section Head of the Capitol Improvement Program in the Administration Planning, Programming and Budget Office (2002-2004), served as the former Transportation Deputy Director for Capitol Improvement and Special Maintenance Programs (2001-2002), and has worked in various positions in the Highways Division with the last being the Project Coordination Section Head for the Highways Division (1999-2001).

Jade Butay, Deputy Director, assumed his position in July 2011. He is responsible for the administrative functions of the Department including personnel administration, central computer services, financial and business management activities, and contract services. Mr. Butay previously served as vice-president of WEBB Construction LLC and a partner with R. Casido Construction LLC. Mr. Butay received a bachelor's degree in Business Administration from the University of Hawaii and a Masters in Business Administration from Babson College.

Alvin Takeshita, PE, Interim Administrator, assumed his present position in August 2011. He is responsible for the operations, maintenance and management of the State Highway System and the planning, design and construction of new state highways and ancillary facilities. He has been an engineer with the Highways Division for over 40 years, most recently serving as the State Traffic Engineer from 2003 to 2011 prior to assuming his current position. Mr. Takeshita graduated from the University of Hawaii in 1971 with a Bachelor of Science in Civil Engineering.

Gerald K.L. Dang, Administrative Services Officer, became the head of the Staff Services Office of the Highways Division in July 1995. He is responsible for project programming, budgeting, fiscal and personnel activities of the Highways Division. Prior to joining the Department, Mr. Dang served as the Administrative Services Officer for the Department of Business, Economic Development and Tourism (1993-1995), and Budget and Accounting Officer for the Department of Accounting and General Services (1990-1993), and Accountant for various State agencies from 1980-1990. Mr. Dang received a bachelor's degree in Business Administration from the University of Hawaii.

Employees

The Highways Division presently has approximately 1,025 positions. Hawaii law grants public employees in Hawaii, except appointed officials and division administrators, the right to organize for the purpose of collective bargaining. Each recognized bargaining unit designates an employee organization as the exclusive representative of all employees of such unit, which organization negotiates with the public employer.

Substantially all of the Highways Division employees are represented by bargaining units. Generally, blue-collar workers are represented by United Public Workers, Local 606, and blue-collar supervisors, white-collar workers and white-collar supervisors are represented by Hawaii Government Employees' Association, Local 152, American Federation of State, County and Municipal Employees. See Appendix C – "GENERAL INFORMATION ABOUT THE STATE OF HAWAII – EMPLOYEE RELATIONS; STATE EMPLOYEES' RETIREMENT SYSTEM – Employee Relations" for more information.

CAPITAL IMPROVEMENT PROGRAM

General

In every odd-numbered year, the Department prepares for the Governor's approval a capital improvements program for the next six fiscal years, describing ongoing and proposed State Highway System capital improvement projects which the Department proposes to undertake during that period. After the Governor's review, the succeeding two fiscal years' capital improvement projects for the State Highway System are submitted to the Legislature as a part of the Administration's executive biennium budget. The Legislature reviews the executive biennium budget in detail and authorizes all or a portion of the executive biennium budget by individual capital improvement project. Subsequently, in every even-numbered year, the Department may amend the second year of that executive biennium budget for presentation to the Governor for approval and to the Legislature for supplemental authorization.

Authorization of a capital improvement project by the Legislature as a part of the executive biennium budget includes the appropriation of moneys from a designated source to pay for that project. Since the Legislature only appropriates for a two-year period, appropriations to complete capital improvement projects extending beyond that period must be approved by subsequent Legislatures. An appropriation of bond funds to match federal funds does not lapse.

The Legislature can appropriate funds for the State Highway System capital improvement projects from six sources: bonds (either general obligation bonds, reimbursable general obligation bonds or revenue bonds), federal funds, the State general fund, special funds, other funds (such as AMTRAK funds) and private contributions (such as private development impact fees). The Legislature also authorizes the issuance of bonds to fund the appropriation for which bond funds are designated as the source for payment of a capital improvement project.

The Department prepares a four-year multimodal transportation improvement program for U.S. Department of Transportation review and approval, and includes two illustrative years beyond the four approved years, to exhibit upcoming efforts. This program, called the Statewide Transportation Improvement Program ("STIP"), includes all projects for which the Department will request federal aid during the four-year period, as well as regionally significant projects. See Appendix B – "ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES, THE STATE HIGHWAY SYSTEM AND THE DEPARTMENT OF TRANSPORTATION" for additional information regarding the STIP.

The Program includes many capital improvement projects still in the preliminary stage. As the Program is continuously developed and revised, the individual capital improvement projects included in the Program undergo changes in priority, timing and cost. The current Program for fiscal years 2011 through 2014 provides authorization for completion of previously approved capital improvement projects, for new capital improvement projects, and for certain additional capital improvement projects which have not yet been authorized.

The Program consists of separate capital improvement projects on the six major islands of the State. From the first year of issuance of Highway Revenue Bonds in 1993 through the 2011 legislative session, the Legislature has appropriated a total of \$4.11 billion, excluding lapses, for the planning, design, and acquisition and construction of projects.

Program Financing Summary

The Governor and the Legislature have approved the funding sources for all appropriations made in prior fiscal years. Of the \$4.11 billion appropriated from 1993 through the 2011 session, excluding lapses, the Department has been authorized to finance approximately \$2.458 billion with federal funds, \$17 million of which consisted of ARRA (American Recovery and Reinvestment Act of 2009) funds, approximately \$322.97 million with available State Highway funds, approximately \$7.23 million with the proceeds from general obligation bonds, approximately \$1.27 billion with the proceeds from the sale of revenue bonds, and approximately \$53.33 million with other funds.

The Department has previously received federal funds for surface transportation projects under the Intermodal Surface Transportation Efficiency Act of 1991 ("ISTEA"), the Transportation Equity Act for the 21st Century of 1998 ("TEA-21"), and the 2005 Safe, Accountable, Efficient Transportation Equity Act: a Legacy for Users (SAFETEA-LU), which authorized federal surface transportation programs for highways, highway safety, and transit for the five-year period from 2005 to 2009. From 2005 to 2009, the Department received obligation authority of \$138.1 million, \$154.1 million, \$167.8 million, \$191.4 million and \$208.0 million, respectively, under the SAFETEA-LU program. Following the September 2009 expiration of SAFETEA-LU, federal fiscal years 2010 and 2011 were funded under continued resolutions provided by the Surface Transportation Extension Act, receiving obligation authority of \$168.8 million and \$130.0 million, respectively (with \$15.0 million transferred out), and the Department anticipates receipt of \$162.6 million in 2012 through a new Transportation Act or through successive continuing resolutions. In addition to funding provided under these acts, the Department also received \$125.7 million under the American Recovery and Reinvestment Act of 2009.

Historically the Department financed a major portion of the State's share of the cost of capital improvement projects using reimbursable general obligation bonds. The Department is required to reimburse the State general

fund for the payment of the principal of and interest on such bonds. See “DEBT SERVICE COVERAGE – Reimbursable General Obligation Bonds” for additional information.

Beginning in 1993, the State determined to finance the Program by issuing revenue bonds secured by a pledge of the Pledged Funds rather than by issuing reimbursable general obligation bonds. The Department issued revenue bonds in the principal amounts of \$75,000,000 in 1993, \$55,000,000 in 1996, \$94,920,000 in 1998, \$50,000,000 in 2000, \$70,000,000 in 2001, \$44,940,000 in 2003, \$183,915,000 in 2005 (\$123,915,000 of which were refunding bonds), and \$125,175,000 in 2008. There is currently \$319,850,000 aggregate principal amount of such bonds outstanding.

DEBT SERVICE COVERAGE

Projected Revenues

The Department’s current forecast of Revenues assumes that future Revenues will grow at a lower rate than the historical growth. The forecast reflects an upward growth trend, with Revenues increasing at an average annual rate of approximately 1.3%, exclusive of any fuel tax rate increase.

The actual Revenues which will be collected and deposited into the State Highway Fund may vary from this projection because of fluctuating economic conditions, changes by the Legislature in the laws governing the Pledged User Taxes and other variables affecting Revenues. Such variances could be material.

Projected Revenues Fiscal Years Ending June 30, 2012 through 2017 (in thousands)

Pledged User Taxes

<u>Fiscal Year</u>	<u>Fuel Taxes</u>	<u>Registration Fees</u>	<u>Weight Taxes</u>	<u>Rental/Tour Vehicle Surcharge</u>	<u>Interest</u>	<u>Misc.*</u>	<u>Total Revenues</u>
2012	\$91,583	\$32,999	\$52,920	\$44,550	\$5,000	\$5,330	\$232,382
2013	92,957	41,683	66,846	45,218	5,000	5,399	257,103
2014	94,351	42,100	67,681	45,897	5,000	5,470	260,499
2015	95,766	42,521	68,527	46,585	5,000	5,534	263,933
2016	97,203	42,946	69,384	47,284	5,000	5,600	267,417
2017	98,661	43,375	70,251	47,993	5,000	5,666	270,946

* Miscellaneous Revenues include vehicle weight tax penalties, periodic motor vehicle inspection charges, rents from State Highway System properties, commercial license fees, and other miscellaneous Revenues.

Source: Department of Transportation.

Debt Service Requirements for the Bonds

The following table sets forth the principal and interest requirements for the Series 2011 Bonds and the Outstanding Bonds:

Revenue Bond Debt Service						
FY Ending 6/30	Outstanding Bonds Debt Service	Less Refunded Bonds Debt Service	Series 2011 Bonds Debt Service			Total Debt Service
			Principal	Interest	Total	
2012	\$ 38,473,810	\$ (135,000)				\$ 38,338,810
2013	38,408,485	(270,000)	\$ 3,690,000	\$ 5,538,637	\$ 9,228,637	47,367,122
2014	38,386,373	(270,000)	3,985,000	5,241,650	9,226,650	47,343,023
2015	38,584,791	(270,000)	4,105,000	5,122,100	9,227,100	47,541,891
2016	38,565,885	(270,000)	4,290,000	4,940,900	9,230,900	47,526,785
2017	38,547,323	(270,000)	4,480,000	4,747,850	9,227,850	47,505,173
2018	38,481,618	(270,000)	4,675,000	4,555,025	9,230,025	47,441,643
2019	38,453,644	(270,000)	4,835,000	4,391,425	9,226,425	47,410,069
2020	23,890,275	(270,000)	5,045,000	4,183,225	9,228,225	32,848,500
2021	23,872,950	(270,000)	5,270,000	3,956,225	9,226,225	32,829,175
2022	19,842,331	(270,000)	5,510,000	3,719,600	9,229,600	28,801,931
2023	20,561,950	(5,535,000)	5,755,000	3,471,650	9,226,650	24,253,600
2024	15,028,700	--	5,995,000	3,234,850	9,229,850	24,258,550
2025	15,033,475	--	6,280,000	2,950,100	9,230,100	24,263,575
2026	15,031,225	--	6,575,000	2,651,100	9,226,100	24,257,325
2027	10,460,813	--	6,890,000	2,337,350	9,227,350	19,688,163
2028	10,458,375	--	7,235,000	1,992,850	9,227,850	19,686,225
2029	10,456,900	--	7,600,000	1,631,100	9,231,100	19,688,000
2030	--	--	7,980,000	1,251,100	9,231,100	9,231,100
2031	--	--	8,375,000	852,100	9,227,100	9,227,100
2032	--	--	8,795,000	433,350	9,228,350	9,228,350
TOTAL	\$472,538,921	\$(8,370,000)	\$117,365,000	\$67,202,187	\$184,567,187	\$648,736,108

Source: Department of Transportation.

Historic and Projected Debt Service Coverage

The following table sets forth historical and projected debt service coverage for fiscal years ending June 30, 2005 through 2017. Revenues for the fiscal years ending June 30, 2005 through 2010 are based on actual Revenues for such fiscal years; projected Revenues for present and future fiscal years are based on the Department's projections identified in the table entitled "Projected Revenues" under "DEBT SERVICE COVERAGE" herein.

Historic and Projected Debt Service Coverage (Revenue Bond Debt Service Only)

<u>Fiscal Year</u>	<u>Pledged Revenues</u>	<u>Outstanding Revenue Bond Debt Service*</u>	<u>Series 2011 Bonds Debt Service</u>	<u>Aggregate Revenue Bond Debt Service</u>	<u>Coverage (Revenue Bonds)</u>
2005	\$ 190,438,000	\$ 22,937,803	\$ --	\$ 22,937,803	8.30x
2006	204,287,000	24,355,200	--	24,355,200	8.39x
2007	210,989,000	28,120,383	--	28,120,383	7.50x
2008	211,855,000	28,127,228	--	28,127,228	7.53x
2009	189,498,000	28,092,053	--	28,092,053	6.75x
2010	184,648,000	38,490,398	--	38,490,398	4.80x
2011	197,130,000	38,550,498	--	38,550,498	5.11x
2012	232,382,000	38,338,810	--	38,338,810	6.06x
2013	257,103,000	38,138,485	9,228,637	47,367,122	5.43x
2014	260,499,000	38,116,373	9,226,650	47,343,023	5.50x
2015	263,933,000	38,314,791	9,227,100	47,541,891	5.55x
2016	267,417,000	38,295,885	9,230,900	47,526,785	5.63x
2017	270,946,000	38,277,323	9,227,850	47,505,173	5.70x

* Net of Refunded Bonds.

Source: Department of Transportation.

**Historic and Projected Debt Service Coverage
(Total Debt Service Supported by Highway Revenue)**

<u>Fiscal Year</u>	<u>Pledged Revenues</u>	<u>Outstanding Revenue Bond Debt Service*</u>	<u>Series 2011 Bonds Debt Service</u>	<u>Aggregate Revenue Bond Debt Service</u>	<u>G.O. Debt Service</u>	<u>Total Debt Supported By Highway Revenue</u>	<u>Coverage (Revenue and G.O. Bonds)</u>
2005	\$ 190,438,000	\$ 22,937,803	\$ --	\$ 22,937,803	\$ 10,858,121	\$ 33,795,924	5.63x
2006	204,287,000	24,355,200	--	24,355,200	20,218,205	44,573,405	4.58x
2007	210,989,000	28,120,383	--	28,120,383	17,686,416	45,806,799	4.61x
2008	211,855,000	28,127,228	--	28,127,228	17,117,257	45,244,485	4.68x
2009	189,498,000	28,092,053	--	28,092,053	16,488,939	44,580,992	4.25x
2010	184,648,000	38,490,398	--	38,490,398	10,723,903	49,214,301	3.75x
2011	197,130,000	38,550,498	--	38,550,498	10,438,425	48,988,923	4.02x
2012	232,382,000	38,338,810	--	38,338,810	7,391,413	45,730,223	5.08x
2013	257,103,000	38,138,485	9,228,637	47,367,122	4,035,344	51,402,466	5.00x
2014	260,499,000	38,116,373	9,226,650	47,343,023	3,208,768	50,551,791	5.15x
2015	263,933,000	38,314,791	9,227,100	47,541,891	2,948,666	50,490,557	5.23x
2016	267,417,000	38,295,885	9,230,900	47,526,785	1,580,128	49,106,913	5.45x
2017	270,946,000	38,277,323	9,227,850	47,505,173	1,119,298	48,624,471	5.57x

* Net of Refunded Bonds.

Source: Department of Transportation.

Reimbursable General Obligation Bonds

As of June 30, 2011, there were outstanding \$24,524,000 reimbursable general obligation bonds issued for the State Highway System. These bonds are general obligation bonds of the State, but since the proceeds of these bonds were used to finance improvements to the State Highway System, the Department is required to reimburse the State general fund for the payment of the principal of and interest on such bonds. Reimbursement currently is made principally from the Pledged User Taxes, and occurs after the payment of the principal of and interest on the Bonds, including reserves therefore, and the costs of operation and maintenance and improvement of the State Highway System.

The following table sets forth the principal and interest requirements for all reimbursable general obligation bonds outstanding as of June 30, 2011. Debt service requirements on the reimbursable general obligation bonds are set forth in the year in which they are scheduled to be paid. There are no current legislative authorizations for additional reimbursable general obligation bond funded State highway projects.

**State Highway System
Reimbursable General Obligation Bond Debt Service**

<u>Fiscal Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total Reimbursable General Obligation Bond Debt Service</u>
2005	\$ 6,465,070	\$ 4,393,051	\$ 10,858,121
2006	16,119,899	4,098,306	20,218,205
2007	14,296,149	3,390,267	17,686,416
2008	14,413,816	2,703,441	17,117,257
2009	14,481,840	2,007,099	16,488,939
2010	9,374,688	1,349,215	10,723,903
2011	9,540,848	897,577	10,438,425
2012	6,889,837	501,575	7,391,413
2013	3,837,938	197,406	4,035,344
2014	3,092,966	115,802	3,208,768
2015	2,881,649	67,018	2,948,666
2016	1,555,327	24,801	1,580,128
2017	1,105,886	13,412	1,119,298
2018	19,328	4,136	23,464
2019	20,308	3,170	23,477
2020	21,334	2,154	23,488
2021	<u>22,409</u>	<u>1,088</u>	<u>23,496</u>
TOTAL	\$104,139,292	\$19,769,518	\$123,908,808

Source: Department of Transportation.

LITIGATION

The State is subject to litigation in connection with the day-to-day operation of the State Highway System by the Department. There are no claims or judicial proceedings affecting the State Highway System or the Pledged Funds, except for claims incidental to the operation of the State Highway System. The State is self-insured with respect to tort claims against the Department and the State Highway System. To pay for tort judgments and settlements involving the State Highway System, the Legislature appropriates money from the State Highway Fund after providing for payment of the Bonds and required reserves. There is no litigation now pending or threatened to restrain or to enjoin the issuance and delivery of the Series 2011 Bonds or the power and authority of the Department or the State to impose, prescribe or collect Pledged User Taxes or in any manner questioning the power and authority of the Department or State to impose, prescribe or collect such Pledged User Taxes or to issue and deliver the Series 2011 Bonds or affecting the validity of the Series 2011 Bonds.

TAX MATTERS

General

In the opinion of Sidley Austin LLP, San Francisco, California, Bond Counsel, based on existing statutes, regulations, rulings and judicial decisions and assuming compliance by the State of Hawaii with certain covenants in the Certificate and requirements of the Internal Revenue Code of 1986, as amended (the "Code"), regarding the use, expenditure and investment of proceeds of the Series 2011 Bonds and the timely payment of certain investment earnings to the United States, interest on the Series 2011 Bonds is not includable in the gross income of the owners of the Series 2011 Bonds for federal income tax purposes. Failure to comply with such covenants and requirements may cause interest on the Series 2011 Bonds to be included in gross income retroactively to the date of issuance of the Series 2011 Bonds.

In the further opinion of Bond Counsel, interest on the Series 2011 Bonds is not treated as an item of tax preference in calculating the federal alternative minimum taxable income of individuals and corporations. Interest on the Series 2011 Bonds, however, is included as an adjustment in the calculation of federal corporate alternative minimum taxable income and may therefore affect a corporation's alternative minimum tax liability.

Ownership of, or the receipt of interest on, tax-exempt obligations may result in collateral tax consequences to certain taxpayers, including, without limitation, financial institutions, property and casualty insurance companies, certain foreign corporations doing business in the United States, certain S corporations with excess passive income, individual recipients of Social Security or Railroad Retirement benefits, taxpayers that may be deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations and taxpayers who may be eligible for the earned income tax credit. Bond Counsel expresses no opinion with respect to any collateral tax consequences and, accordingly, prospective purchasers of the Series 2011 Bonds should consult their tax advisors as to the applicability of any collateral tax consequences.

Certain requirements and procedures contained or referred to in the Certificate may be changed, and certain actions may be taken or not taken, under the circumstances and subject to the terms and conditions set forth in such documents, upon the advice or with the approving opinion of counsel nationally recognized in the area of tax-exempt obligations. Bond Counsel expresses no opinion as to the effect of any change to any document pertaining to the Series 2011 Bonds or of any action taken or not taken where such change is made or action is taken or not taken without our approval or in reliance upon the advice of counsel other than Sidley Austin LLP with respect to the exclusion from gross income of the interest on the Series 2011 Bonds for federal income tax purposes.

Bond Premium

Certain of the Series 2011 Bonds may be purchased in the initial offering for an amount in excess of their principal amount (hereinafter, the "Premium Bonds"). The excess of the tax basis of a purchaser of a Premium Bond (other than a purchaser who holds a Premium Bond as inventory, stock in trade or for sale to customers in the ordinary course of business) over the principal amount of such Premium Bond is "bond premium." Bond premium is amortized for federal income tax purposes over the term of a Premium Bond based on the purchaser's yield to maturity in the Premium Bond, except that in the case of a Premium Bond callable prior to its stated maturity, the amortization period and the yield may be required to be determined on the basis of an earlier call date that results in the lowest yield on such Premium Bond. A purchaser of a Premium Bond is required to decrease his or her adjusted basis in such Premium Bond by the amount of bond premium attributable to each taxable year in which such purchaser holds such Premium Bond. The amount of bond premium attributable to a taxable year is not deductible for federal income tax purposes. Purchasers of Premium Bonds should consult their tax advisors with respect to the precise determination for federal income tax purposes of the amount of bond premium attributable to each taxable year and the effect of bond premium on the sale or other disposition of a Premium Bond, and with respect to the State and local tax consequences of owning and disposing of a Premium Bond.

Information Reporting and Backup Withholding

Interest paid on tax-exempt obligations is subject to information reporting in a manner similar to interest paid on taxable obligations. While this reporting requirement does not, by itself, affect the excludability of interest from gross income for federal income tax purposes, the reporting requirement causes the payment of interest on the Series 2011 Bonds to be subject to backup withholding if such interest is paid to beneficial owners that (a) are not "exempt recipients," and (b) either fail to provide certain identifying information (such as the beneficial owner's taxpayer identification number) in the required manner or have been identified by the IRS as having failed to report all interest and dividends required to be shown on their income tax returns. Generally, individuals are not exempt recipients, whereas corporations and certain other entities are exempt recipients. Amounts withheld under the backup withholding rules from a payment to a beneficial owner are allowed as a refund or credit against such beneficial owner's federal income tax liability so long as the required information is furnished to the IRS.

State Tax Exemption

In the further opinion of Bond Counsel, interest on the Series 2011 Bonds is exempt from all taxation by the State of Hawaii or any county or other political subdivision thereof, except inheritance, transfer, and estate taxes

and the franchise tax imposed on banks and other financial institutions pursuant to Chapter 241 of Title 14 of the Hawaii Revised Statutes.

Future Developments

Future or pending legislative proposals, if enacted, regulations, rulings or court decisions may cause interest on the Series 2011 Bonds to be subject, directly or indirectly, to federal income taxation or to State or local income taxation, or may otherwise prevent beneficial owners from realizing the full current benefit of the tax status of such interest. Legislation or regulatory actions and future or pending proposals may also affect the economic value of the federal or State tax exemption or the market value of the Series 2011 Bonds. Prospective purchasers of the Series 2011 Bonds should consult their tax advisors regarding any future, pending or proposed federal or State tax legislation, regulations, rulings or litigation as to which Bond Counsel expresses no opinion.

For example, based on a proposal by the President, the Senate Majority Leader introduced a bill, S. 1549 (the "Proposed Legislation"), which, if enacted, would subject interest on bonds that is otherwise excludable from gross income for federal income tax purposes, including interest on the Series 2011 Bonds, to a tax payable by certain bondholders that are individuals, estates or trusts with adjusted gross income in excess of thresholds specified in the Proposed Legislation in tax years beginning after December 31, 2012. The Proposed Legislation would also provide special rules for such bondholders that are also subject to the alternative minimum tax. It is unclear if the Proposed Legislation will be enacted, whether in its current or an amended form, or if other legislation that would subject interest on the Series 2011 Bonds to a tax or cause interest on the Series 2011 Bonds to be included in the computation of a tax, will be introduced or enacted. Prospective purchasers should consult their tax advisors as to the effect of the Proposed Legislation, if enacted, in its current form or as it may be amended, or such other legislation on their individual situations.

A copy of the proposed form of opinion of Bond Counsel is attached hereto as Appendix E.

CERTAIN LEGAL MATTERS

Certain legal matters incident to the authorization, issuance and sale of the Series 2011 Bonds are subject to the approving legal opinion of Sidley Austin LLP, who has been retained by, and acts as, Bond Counsel to the State. Bond Counsel has not been retained or consulted on disclosure matters and has not undertaken to review or verify the accuracy, completeness or sufficiency of this Official Statement or other offering material relating to the Series 2011 Bonds and assumes no responsibility for the statements or information contained in or incorporated by reference in this Official Statement, except that in its capacity as Bond Counsel, Sidley Austin LLP has, at the request of the State reviewed the information under the headings "THE SERIES 2011 BONDS," "PLAN OF FINANCE," "SECURITY FOR THE BONDS," "CONTINUING DISCLOSURE" and "TAX MATTERS," as well as Appendices A and F. This review was undertaken solely at the request and for the benefit of the State and did not include any obligation to establish or confirm factual matters set forth herein. Copies of the approving opinion of Bond Counsel will be available at the time of delivery of the Series 2011 Bonds. The form of opinion Bond Counsel proposes to render is set forth in Appendix E hereto. Certain legal matters will be passed upon for the Underwriters by their counsel, McCorriston Miller Mukai MacKinnon LLP.

The Ninth Supplemental Certificate of the Director, providing for the issuance of the Series 2011 Bonds, will be approved as to form and legality by the Attorney General of the State.

RATINGS

Fitch, Moody's Investors Service, and Standard & Poor's have assigned ratings of "AA," "Aa2" and "AA+" respectively, to the Series 2011 Bonds. Such ratings reflect only the views of such organizations and any desired explanation of the significance of such ratings should be obtained from the rating agency furnishing the same, at the following addresses: Fitch Ratings, One State Street Plaza, New York, New York 10004; Moody's Investors Service, 7 World Trade Center at 250 Greenwich Street, New York, New York 10007; Standard & Poor's Rating Services, 55 Water Street, New York, New York 10041. Generally a rating agency bases its rating on the information and materials furnished to it and on investigations, studies and assumptions of its own. There is no

assurance that such ratings will continue for any given period of time or that such ratings will not be revised downward, suspended or withdrawn entirely by the rating agencies if, in the judgment of such rating agencies, circumstances so warrant. The State undertakes no responsibility to oppose any such revision, suspension or withdrawal. Any such downward revision, suspension or withdrawal of such ratings may have an adverse effect on the market price of the Series 2011 Bonds.

UNDERWRITING

Subject to the terms and conditions of the Underwriting Agreement, the issuer has agreed to sell to Robert W. Baird & Co., Incorporated and RBC Capital Markets, LLC (together, the “Underwriters”), and the Underwriters have agreed to purchase from the issuer, all of the Series 2011 Bonds. The Underwriters have agreed to purchase the Series 2011 Bonds at a price of \$130,245,782.35, being the aggregate principal amount of the Bonds plus the original issue premium of \$13,618,826.20, less an underwriting discount of \$738,043.85. The Underwriters will be responsible for the payment of certain costs of issuing the Series 2011 Bonds. The Underwriting Agreement provides that the Underwriters will purchase all of the Series 2011 Bonds if any are purchased, the obligation to make such purchase being subject to certain terms and conditions set forth in the Underwriting Agreement, the approval of certain legal matters by counsel and certain other conditions. The initial public offering prices of the Series 2011 Bonds may be changed from time to time by the Underwriters. The Underwriters may offer and sell the Series 2011 Bonds to certain dealers (including dealers depositing Series 2011 Bonds into unit investment trusts, certain of which may be sponsored or managed by the Underwriters) at prices lower than the public offering prices stated on the cover of this Official Statement.

CONTINUING DISCLOSURE

The Department has executed a Continuing Disclosure Certificate (the “Disclosure Certificate”) for the benefit of the Holders and beneficial owners of the Series 2011 Bonds to provide annually certain financial information and operating data relating to the Department and to provide notice of the occurrence of certain enumerated events to the Municipal Securities Rulemaking Board pursuant to the requirements of Section (b)(5)(i) of Securities and Exchange Commission Rule 15c2-12 (17 C.F.R. § 240.15c2-12) (the “Rule”). See Appendix F – “FORM OF CONTINUING DISCLOSURE CERTIFICATE.”

A failure by the Department to comply with the Disclosure Certificate will not constitute an event of default under the Certificate or on the Series 2011 Bonds. Any such failure must be reported in accordance with the Rule and must be considered by any broker, dealer or municipal securities dealer before recommending the purchase or sale of the Series 2011 Bonds in the secondary market. Consequently, such a failure may adversely affect the transferability and liquidity of the Series 2011 Bonds and their market price.

Within the last five years, the Department has not failed to comply in all material respects with any previous undertaking with regard to the Rule to provide annual reports or notices of listed events, *except* that the Department’s required annual reports for fiscal year 2010, although filed in a timely manner, inadvertently omitted certain financial information relating to the Highways Division. The Department filed the entire annual report promptly after discovering the omission, and believes it has adequately addressed the causes for the error so that similar omissions do not occur in the future.

The obligations of the Department described in the Disclosure Certificate will remain in effect until the Series 2011 Bonds are no longer Outstanding (within the meaning of the Certificate) or the Rule no longer applies to the Series 2011 Bonds. Any provision of the Disclosure Certificate may be amended or waived upon the conditions set forth therein.

The Disclosure Certificate is solely for the benefit of the Holders and beneficial owners from time to time of the Series 2011 Bonds. The exclusive remedy for any breach of the Disclosure Certificate by the Department is limited to the right of the Holders and beneficial owners to cause to be instituted and maintained proceedings to obtain specific performance by the Department of its obligations under the Disclosure Certificate. Any such proceedings challenging the adequacy of the information provided in accordance with the Disclosure Certificate

may be instituted and maintained only by Holders and beneficial owners of not less than 25% in principal amount of the Series 2011 Bonds then Outstanding.

FINANCIAL STATEMENTS

The audited financial statements of the Highways Division as of and for the fiscal year ended June 30, 2010 are set forth in Appendix D to this Official Statement. These financial statements have been audited by KMH LLP, Honolulu, Hawaii, independent certified public accountants, whose report is set forth in Appendix D.

CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING STATEMENTS

Certain statements included or incorporated by reference in this Official Statement constitute “forward-looking statements.” Such statements are generally identifiable by the terminology used such as “plan,” “expect,” “estimate,” “budget” or similar words. Such forward-looking statements include, among others, statements found under “DEBT SERVICE COVERAGE—Projected Revenues,” “ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES, THE STATE HIGHWAY SYSTEM AND THE DEPARTMENT OF TRANSPORTATION” in Appendix B, and “GENERAL INFORMATION ABOUT THE STATE OF HAWAII” in Appendix C.

THE ACHIEVEMENT OF CERTAIN RESULTS OR OTHER EXPECTATIONS CONTAINED IN SUCH FORWARD-LOOKING STATEMENTS INVOLVES KNOWN AND UNKNOWN RISKS, UNCERTAINTIES AND OTHER FACTORS, WHICH MAY CAUSE ACTUAL RESULTS, PERFORMANCE OR ACHIEVEMENTS DESCRIBED TO BE MATERIALLY DIFFERENT FROM ANY FUTURE RESULTS, PERFORMANCE OR ACHIEVEMENTS EXPRESSED OR IMPLIED BY SUCH FORWARD-LOOKING STATEMENTS. THE STATE DOES NOT PLAN TO ISSUE ANY UPDATES OR REVISIONS TO THOSE FORWARD-LOOKING STATEMENTS IF OR WHEN CHANGES OCCUR TO ITS EXPECTATIONS, OR EVENTS, CONDITIONS OR CIRCUMSTANCES ON WHICH SUCH STATEMENTS ARE BASED.

MISCELLANEOUS

The references in this Official Statement to Acts of the Legislature and the Certificate (including the supplements thereto) do not purport to be complete and are subject to the detailed provisions thereof to which reference is hereby made. The Acts and other Hawaii statutes may be amended by the Legislature. The Department has provided the information in this Official Statement relating to the Highways Division, and other matters, as indicated.

All statements in this Official Statement involving matters of opinion, estimates, forecasts, projections, or the like, whether or not expressly so stated, are intended as such and not as representations of fact. No representation is made that any such statements will be realized. The agreements of the Department and the State are fully set forth in the Certificate and the General Revenue Bond Law, and the Official Statement is not to be construed as a contract or agreement between the Department or the State and the purchasers or Holders of any of the Series 2011 Bonds.

DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII

/s/ Glenn Okimoto
By: Glenn Okimoto, Director of Transportation

SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE

For purposes of this Appendix A, Certificate means the Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Highway Revenue Bonds, dated as of August 1, 1993, as heretofore supplemented and as further supplemented by the Ninth Supplemental Certificate. The following is a summary of certain of the provisions of the Certificate. The summary does not purport to be complete or to follow the exact language of the Certificate, and, accordingly, is qualified by reference thereto and is subject to the full text thereof. Capitalized terms not otherwise previously defined in this Official Statement or defined below have the meanings set forth in the Certificate. For the complete provisions of the Certificate and the precise wording thereof, reference should be made to the Certificate, copies of which are available upon request at the office of the Department. Unless clearly indicated otherwise, all section references are to the Certificate only.

Definitions of Certain Terms [Certificate Section 1.01]

The following are definitions in summary form of certain terms contained in the Certificate and used in this Official Statement.

“Aggregate Bond Service” means, as of any date of calculation and with respect to any period, the sum of the amounts of Bond Service for all Series of Bonds for such period.

“Average Annual Bond Service” of a Series of Bonds means the result obtained by dividing (A) the aggregate Bond Service for such Series for the period from the date of issuance of such Series until the final maturity date of such Series by (B) the number of Bond Years in such period.

“Bond” or “Bonds” means any Senior Bond or Subordinate Bond, some of the Senior Bonds or Subordinate Bonds or all the Senior Bonds or Subordinate Bonds.

“Bond Service” means, as of any date of calculation and with respect to any period for any Series of Bonds, an amount equal to the sum of: (i) the interest accruing during such period on the Bonds of such Series, except to the extent that such interest is to be paid from (y) amounts credited to the Highway Senior Interest Subaccount or the Highway Subordinate Interest Subaccount, (z) any other account set aside exclusively for the payment of interest, and (ii) that portion of the next succeeding Principal Installment for the Bonds of such Series accruing during such period assuming each such Principal Installment were deemed to accrue daily (based on a year of 12 months each of 30 days duration) in equal amounts from the next preceding Principal Installment due date (or, in the event there shall have been no such preceding Principal Installment due date for such Series, then from a date one year preceding the due date of such Principal Installment or from the date of delivery of the Bonds of such Series, whichever is later). Such interest and Principal Installments shall be calculated on the assumption that no Bonds of such Series Outstanding at the date of calculation will cease to be Outstanding except by reason of the payment of each Principal Installment for the Bonds of such Series on the due date thereof. The Bond Service definition contains additional provisions concerning the calculation of debt service on Variable Rate Bonds and Capital Appreciation Bonds.

“Bondholder” or “Holder” or “Holder of Bonds” or “Owner” or “Owner of Bonds” means the person in whose name any Bond is registered upon the Bond Registrar maintained by the Registrar pursuant to the Certificate.

“Bond Year” means, with respect to any Series of Bonds, any period of 12 consecutive months terminating on the due date of a Principal Installment for the Bonds of such Series; provided that the initial Bond Year for each Series shall be of such duration as is set forth in the Supplemental Certificate providing for such Series.

“Business Day” means any day of the year other than a day (i) which is a holiday of the State, (ii) on which banks located in any one of the cities in which the principal offices of the (a) Registrar and (b) any Support Provider are located are required or authorized to remain closed, or (iii) on which the New York Stock Exchange is closed.

“Code” means the Internal Revenue Code of 1986, as from time to time amended, and any successor statute thereto, and any Treasury regulations or proposed regulations thereunder. Any reference in the Certificate to any Section of the Code shall be deemed to refer to any amended or successor provision enacted or promulgated after the date of the Certificate, but only with respect to each particular Series of Bonds to the extent effective as to such Series.

“Department” or “Department of Transportation” means the Department of Transportation of the State and any successor thereto.

“Federal Securities” means any of the following:

(i) any direct and general obligations of, or any obligations fully and unconditionally guaranteed as to the full and timely payment of principal and interest by, the United States of America;

(ii) obligations issued or guaranteed by any of the following federal agencies, provided that such obligations are backed by the full faith and credit of the United States of America: Export-Import Bank of the United States (backed by the full faith and credit of USA); Government National Mortgage Association (Ginnie Mae) (backed by the full faith and credit of USA); Public Housing Authority (backed by the full faith and credit of USA); Farm Credit System Financial Assistance Corporation (senior debt rated in highest category by the Rating Agencies); Student Loan Marketing Association (Sallie Mae) (senior debt rated in highest category by the Rating Agencies); Tennessee Valley Authority (senior debt rated in highest category by the Rating Agencies); Inter-American Development Bank (senior debt rated in highest category by the Rating Agencies); World Bank (International Bank for Reconstruction & Development) (senior debt rated in highest category by the Rating Agencies); Federal Farm Credit Banks (Consolidated Systemwide Bonds) (senior debt rated in highest category by the Rating Agencies); Federal Home Loan Banks (consolidated debt of banks and deposits of 8 of the 12 individual banks rated in highest category by the Rating Agencies); Federal Home Loan Mortgage Corp. (senior debt (not subordinated debt) rated in highest category by the Rating Agencies); Federal National Mortgage Association (senior debt (not subordinated debt) rated in highest category by the Rating Agencies); and Resolution Funding Corporation (Refcorp) (rated in highest category by the Rating Agencies);

(iii) any obligations of any state or political subdivision of a state (collectively, “Municipal Bonds”) which Municipal Bonds are either (A) rated “Aaa” by Moody’s and “AAA” by S&P (whether such rating is based upon the credit of the issuer, an insurance policy, a letter of credit or otherwise) or (B) are fully secured as to principal and interest by an irrevocable pledge of moneys or direct and general obligations of, or obligations guaranteed by, the United States of America, which moneys or obligations are segregated in trust and pledged for the benefit of the holder of the Municipal Bonds, and which Municipal Bonds are rated “Aaa” by Moody’s and “AAA” by S&P and provided, however, that such Municipal Bonds are accompanied by (a) an opinion of Bond Counsel to the effect that such Municipal Bonds are not subject to redemption prior to the date the proceeds of such Municipal Bonds will be required for the purposes of the investment being made therein and (b) a report of an Independent Public Accountant verifying that the moneys and obligations so segregated are sufficient to pay the principal of, premium, if any, and interest on the Municipal Bonds; and

(iv) securities commonly referred to as CATs, TGRs, STRIPs, or other certificates of direct ownership of the principal of, or interest on, direct and general obligations of the United States of America or certificates of direct ownership of the interest on obligations of the Resolution Funding Corporation, which obligations are held by a commercial bank which is a member of the Federal Reserve System in trust on behalf of the holders of the derivative product;

provided, however, that the term Federal Securities shall exclude unit investment trusts or mutual funds which otherwise meet the criteria set forth above in clauses (i) through (iv) unless the trust or fund is in the highest rating category of the Rating Agency.

“Event of Default” means any occurrence or event specified in Section 10.01 of the Certificate.

“Fiscal Year” means the fiscal year for the State as established from time to time by the State, being on the effectiveness of the Certificate, the period from July 1 in any year to and including the following June 30.

“Highway Bond Proceeds Account” means the special account created in the State Bond Fund into which shall be credited proceeds of any Bond for the payment of the costs of highway and road projects, and other related facilities and properties constituting a part of the Undertaking.

“Highway Revenue Special Account” means the special account of that name created in the Certificate in the State Highway Fund.

“Highway Senior Debt Service Reserve Subaccount” means the separate special subaccount of the Department created pursuant to the Certificate in the Highway Revenue Special Account and designated as the “Highway Senior Debt Service Reserve Subaccount.”

“Highway Senior Interest Subaccount” means the separate special subaccount of the Department created pursuant to the Certificate in the Highway Revenue Special Account and designated as the “Highway Senior Interest Subaccount.”

“Highway Senior Principal Subaccount” means the separate special subaccount of the Department created pursuant to the Certificate in the Highway Revenue Special Account and designated as the “Highway Senior Principal Subaccount.”

“Highway Subordinate Debt Service Reserve Subaccount” means the separate special subaccount of the Department created pursuant to the Certificate in the Highway Revenue Special Account and designated as the “Highway Subordinate Debt Service Reserve Subaccount.”

“Highway Subordinate Interest Subaccount” means the separate special subaccount of the Department created pursuant to the Certificate in the Highway Revenue Special Account and designated as the “Highway Subordinate Interest Subaccount.”

“Highway Subordinate Principal Subaccount” means the separate special subaccount of the Department created in the Highway Revenue Special Account and designated as the “Highway Subordinate Principal Subaccount.”

“Investment Securities” means any of the following securities, but only if at the time of investment such security is permitted by law as an investment for the fund or account being considered:

- (i) Federal Securities;
- (ii) obligations issued or guaranteed by any of the following United States Government agencies: Federal Home Loan Bank System (senior debt obligations); Federal Home Loan Mortgage Corporation (participation certificates and senior debt obligations); Federal National Mortgage Association (mortgage-backed securities and senior debt obligations); and Student Loan Marketing Association (senior debt obligations);
- (iii) direct and general obligations of any state of the United States of America, to the payment of the principal of and interest on which the full faith and credit of such state is pledged, provided that at the time of their purchase under the Certificate such obligations are rated in either of the two highest major rating categories by the Rating Agency (without taking into account any plus or minus designation or numerical modification used by the Rating Agency to indicate relative standing within a major rating category);
- (iv) repurchase agreements with domestic banks which are members of the Federal Deposit Insurance Corporation and rated “A” or above by the Rating Agencies or government bond dealers recognized as primary dealers by the Federal Reserve Bank of New York, secured by Federal Securities, provided that each such repurchase agreement (a) is in commercially reasonable form, as determined in the sole judgment of the State, and is for a period not to exceed 30 days and (b) results in transfer to the State of legal title to, or the grant to the Paying Agent of a prior perfected security interest in, identified securities referred to in item (i) above which are free and

clear of any claims by third parties and are segregated in a custodial or trust account held by a third party commercial bank with trust powers (other than the repurchaser) as the agent solely of, or in trust solely for the benefit of, the Department; provided that such securities acquired pursuant to such repurchase agreements shall be valued weekly at the lower of the then current market value of such securities or the repurchase price thereof set forth in the applicable repurchase agreement, and if the value of such securities drops below 103% of the value of the cash transferred by the Department, then additional cash and/or acceptable securities must be transferred to the Department from the applicable bank or government bond dealer;

(v) time deposits (which may be represented by certificates of deposit) in any bank or trust company, provided that such time deposits (a) do not exceed at any one time in the aggregate 10% of the total net worth of such bank or trust company, (b) are continuously and fully secured by Federal Securities, which shall have a market value (not including accrued interest) at all times at least equal to the principal amount of such certificates and shall be lodged with the Department, as custodian, by the bank or trust company issuing such certificates, and the bank or trust company issuing each such certificate required to be so secured shall furnish the Department with either the securities pledged to the security thereof or a joint custody receipt evidencing the securities pledged thereunder, or (c) are 100% insured by the Federal Deposit Insurance Corporation;

(vi) Banker's acceptances with a maximum term of one year drawn on and accepted by commercial banks having a total net worth of at least \$50,000,000 (or, in the case of a commercial bank not organized under the laws of the United States of America or any state thereof (in which event the bankers' acceptances shall be dollar-denominated), a total net worth of at least \$1,000,000,000) and having an unsecured, uninsured and unguaranteed obligation rating of "Prime-1" or "A3" or better by Moody's and "A-1" or "A" or better by S&P;

(vii) Commercial or finance company paper of a maturity not in excess of one (1) year which is rated in the highest short-term rating category by the Rating Agency (without taking into account any plus or minus designation or numerical modification used by the Rating Agency to indicate relative standing within a major rating category);

(viii) Corporate bonds rated in one of the two highest rating categories by the Rating Agency (without taking into account any plus or minus designation or numerical modification used by the Rating Agency to indicate relative standing within a major rating category);

(ix) investment agreements rated no lower than the second highest rating category given by the Rating Agency and if not so rated then investment agreements with companies or banks whose senior debt obligations are rated no lower than the second highest rating category given by the Rating Agency (without taking into account any plus or minus designation or numerical modification used by the Rating Agency to indicate relative standing within a major rating category) at the time of the execution and delivery of such agreement;

(x) short term obligations by or on behalf of any state of the United States of America or political subdivision thereof provided at the time of their purchase under the Certificate such obligations are rated in the highest short-term category by the Rating Agency (without taking into account any plus or minus designation or numerical modification used by the Rating Agency to indicate relative standing within a major rating category);

(xi) any cash sweep or similar account arrangement of the Paying Agent the investments of which are limited to investments described in items (i) or (ii) of this definition of Investment Securities and any money market fund rated in the highest category by the Rating Agency the entire investments of which are limited to investments described in (i) or (ii) of this definition of Investment Securities; and

(xii) any other investments authorized by the Department if, after written notification to the Rating Agency, written notification is received from the Rating Agency confirming that the use of such investments will not result in a downgrading of the then current rating of the Bonds Outstanding (taking into account for such purposes any minus designation or numerical modification used by the Rating Agency to indicate relative standing within a major rating category).

"Operation and Maintenance Expenses" means the expenses of operation, maintenance and repair of the properties constituting the Undertaking, including without limitation, the cost of equipment and general

administrative overhead in connection with those properties, but excluding any (i) arbitrage earnings which are required to be paid to the United States Government pursuant to Section 148 of the Code, (ii) depreciation expense, and (iii) surcharges imposed by the State for central services relating to administration of funds of the Department.

“Opinion of Counsel” means a written opinion of counsel experienced in the field of law relating to the opinion being rendered, retained by the Department and which, with respect to the Federal tax law relating to the tax-exempt obligations is nationally recognized.

“Outstanding”, when used with respect to any Bond, shall have the construction given to such word in Section 11.01 of the Certificate, as described below under “Discharge of Obligations of the State Under the Certificate”. For purposes of the Certificate, in the event any Bonds of a Series are issued and sold at a price such that a portion or all of the interest thereon is intended to be earned by accrual of original issue discount or the compounding of interest, the amount of such Bonds deemed to be Outstanding for the purpose of calculating the principal amount of any such Bonds and the principal amount of Bonds Outstanding in connection with the exercise of any voting right or privilege, the giving of any consent or direction or the taking of any other action that the Holders of the Bonds are entitled to take pursuant to Articles X and XI of the Certificate or otherwise, shall be the accreted value thereof.

“Paying Agents” means the Director of Finance of the State, and, for any Series of Bonds, the additional paying agents therefor appointed, pursuant to Section 7.02 of the Certificate, in the Supplemental Certificate providing for the issuance of such Bonds.

“Pledged Funds” means the Revenues and the moneys held in the Highway Revenue Special Account, the Highway Bond Proceeds Account and such other funds and accounts which may be hereafter pledged to the payment of the principal of and interest on the Bonds.

“Pledged User Taxes” means the highway fuel license taxes, the vehicle weight taxes, the vehicle registration fees, the rental motor vehicle surcharge taxes and tour vehicle surcharge taxes levied and paid pursuant to Sections 243-4, 248-8, 249-33, 249-31, and 251-2, Hawaii Revised Statutes, and other user taxes, fees or charges currently or hereafter derived from or arising through the ownership, operation, and management of the Undertaking and the furnishing and supplying of the services thereof, which are deposited in the State Highway Fund and made available pursuant to State law for the payment of the Bonds.

“Principal Installment” means, as of any date of calculation and with respect to any Series of Bonds, so long as any Bonds thereof are Outstanding: (i) the principal amount of Bonds of such Series due on a certain future date for which no Sinking Fund Installments have been established, or (ii) the unsatisfied balance (determined as provided in the definition of “Sinking Fund Installment”) of any Sinking Fund Installment due on a certain future date for Bonds of such Series which would be applicable upon redemption of such Bonds on such future date in a principal amount equal to such unsatisfied balance of such Sinking Fund Installment, or (iii) if such future dates coincide as to different Bonds of such Series, the sum of such principal amount of Bonds and of such unsatisfied balance of such Sinking Fund Installment due on such future date.

“Rating Agency” means Moody’s Investors Service and Standard & Poor’s, a Division of The McGraw-Hill Companies, Inc. and their respective successors and assigns or, if either (or both) shall for any reason no longer perform the functions of a securities rating agency, such other nationally recognized rating agency designated by the Department; provided, however, that any reference to a Rating Agency in the Certificate other than in the definition of Federal Securities and Investment Securities) shall only be effective while such Rating Agency is providing a rating on the Outstanding Bonds.

“Redemption Price” means with respect to any Bond, the principal amount thereof plus the applicable premium, if any, payable upon redemption thereof pursuant to the Certificate or any Supplemental Certificate.

“Registrar” means the entity defined as Registrar to the Certificate.

“Reimbursable General Obligation Bonds” means general obligation bonds of the State to which the State has pledged its full faith and credit and which are payable from the general fund of the State, the proceeds of which

were or are to be used to finance highway and road projects with respect to properties constituting part of the Undertaking, and with respect to which the general fund of the State is to be reimbursed from Revenues, except insofar as the obligation or reimbursement has been or is canceled by the State Legislature.

“Reserve Requirement” means with respect to Senior Bonds or Subordinate Bonds, an amount, as of any date of determination, equal to one-half (1/2) of the maximum Aggregate Bond Service for Senior Bonds or Subordinate Bonds, as the case may be, in any Bond Year, beginning with the Bond Year in which the date of determination occurs and ending with the Bond Year after which no Senior Bonds or Subordinate Bonds, as the case may be, are Outstanding.

“Revenues” means and includes the items set forth below when and to the extent the same are deposited in the State Highway Fund to the credit of the Highway Revenue Special Account: (A) all income, revenues and moneys collected by the State from the ownership or operation of the Undertaking or the supplying and furnishing of the services, facilities and commodities thereof, and without limiting the generality of the foregoing, shall include all income, revenues and moneys derived from rates, rentals, fees, tolls and charges prescribed for the uses and services of, and the facilities and commodities furnished by, the Undertaking; (B) earnings on the investment of moneys held under the Certificate and the proceeds of the sale of any such investments; (C) income, revenues and moneys paid to the State or the Department with respect to properties that constitute part of the Undertaking on the effective date of the Certificate but are sold, leased or otherwise disposed of or transferred pursuant to the provisions of the Certificate so as to no longer constitute part of the Undertaking; (D) the Pledged User Taxes; and (E) any other moneys or funds deposited by the State or the Department into the Highway Revenue Special Account; provided, however, that the term “Revenues” shall not include: (i) moneys received as proceeds from the sale of Bonds; (ii) condemnation proceeds or insurance proceeds except insurance proceeds received from rental or business interruption insurance; (iii) grants-in-aid or similar payments received from the Federal Government or public agencies if (1) the application of such moneys are restricted to a specific purpose other than payment of principal of and interest on indebtedness of the State, or (2) such grants or payments constitute a reimbursement to the State for expenditures previously made from the State Highway Fund or the Highway Revenue Special Account; (iv) moneys or securities received by the State or the Department as gifts or grants, the use of which is restricted by the donor or grantor; (v) investment income derived from any moneys or securities which may be placed in escrow or trust to defease bonds of the State, including the Bonds, or which may be held in the Highway Bond Proceeds Account; (vi) any arbitrage earnings which are required to be paid to the United States Government pursuant to Section 148(f) of the Code; and (vii) the proceeds of any Support Facility.

“Senior Bond” or “Senior Bonds” means any Bond, some of the Bonds or all of the Bonds issued under and at any time Outstanding pursuant to the Certificate, being the Highway Revenue Bonds, Series 1998, Series 2001, Series 2003, 2005 Series A and B, Series 2008, any Additional Senior Bonds issued pursuant to the Certificate, and any Refunding Senior Bonds issued pursuant to the Certificate.

“Series” means all of the Bonds designated as being of the same Series which are authenticated and delivered on original issuance in a simultaneous transaction.

“Sinking Fund Installment” means, with respect to each Series of Bonds, the amount designated as such in the Supplemental Certificate authorizing such Series of Bonds. The portion of any such Sinking Fund Installment remaining after the deduction of any such amounts credited pursuant to the Certificate toward the same (as the original amount of any such Sinking Fund Installment if no such amounts shall have been credited toward the same) shall constitute the unsatisfied balance of such Sinking Fund Installment for the purpose of calculation of Sinking Fund Installments due on a future date.

“State” means the State of Hawaii.

“State Bond Fund” means the fund created in the Treasury of the State by Section 40-2, Hawaii Revised Statutes, into which certain available moneys and proceeds of bonds and other obligations of the State and its various departments are deposited for the payment of capital projects and improvements and other public purposes.

“State Highway Fund” means the special fund of that name created in the Treasury of the State by Section 248-8, Hawaii Revised Statutes.

“Subordinate Bond” or “Subordinate Bonds” means any Bond, some of the Bonds or all of the Bonds issued under and at any time Outstanding pursuant to the Certificate, being any Additional Subordinate Bonds and any Refunding Subordinate Bonds issued pursuant to the Certificate.

“Supplemental Certificate” or “Certificate supplemental to the Certificate,” means a certificate duly issued by the Director of Transportation for any of the purposes of Article X of the Certificate or otherwise amendatory of or supplemental to the Certificate but only if and to the extent specifically authorized thereunder.

“Support Agreement” means the agreement or agreements, if any, entered into by the Department which provides for a Support Facility, and any and all modifications, alterations, amendments and supplemental thereto.

“Support Facility” means any instrument such as a letter of credit, a committed line of credit, an insurance policy, a surety bond or a standby bond purchase agreement, or any combination of the foregoing, and issued by a bank or banks, other financial institution or institutions, or any combination of the foregoing, which provides for: (i) with respect to any Series of Bonds, the payment of all or a portion of the purchase price or principal, premium, if any, or interest due or to become due on specified Bonds of such Series, or providing for the purchase of such Bonds or a portion thereof by the issuer of such Support Facility; or (ii) with respect to the Highway Senior Debt Service Reserve Subaccount or the Highway Subordinate Debt Service Reserve Subaccount, the funding, in whole or in part, of the Reserve Requirement.

“Support Provider” means a financial institution which provides a Support Facility.

“Undertaking” means and includes all highways and roads, and other related facilities and properties (real, personal or mixed) now belonging to or controlled by the State and under the administration, jurisdiction, control and management of the Department, and all improvements, betterments or extensions thereto hereafter constructed or acquired, except bikeways, and without limiting the generality of the foregoing, the term “Undertaking” shall include each and every, all and singular, the properties and facilities constructed or acquired from the proceeds of Bonds issued under the Certificate or constructed or acquired from the proceeds of any other bonds, notes or other evidences of indebtedness payable, or the principal and interest of which is reimbursable, from the State Highway Fund or from a fund maintained therefrom, or constructed or acquired from moneys in the State Highway Fund or in any other fund maintained therefrom.

“Value of Investment Securities” and words of like import means the amortized value thereof, provided, however, that all United States Treasury Obligations – State and Local Government Series shall be valued at par and those obligations which are redeemable or otherwise subject to payment (including purchase) at the option of the owner thereof shall be valued at the price at which such obligations are then redeemable or otherwise subject to payment. The computations made under this definition shall include accrued interest on the Investment Securities paid as a part of the purchase price thereof and not collected. For the purposes of this definition, “amortized value”, when used with respect to a security purchased at par, means the purchase price of such security and when used with respect to a security purchased at a premium above or discount below par means, as of any subsequent date of valuation, the value obtained by dividing the total premium or discount by the number of interest payment dates remaining to maturity on any such security after such purchase and by multiplying the amount so calculated by the number of interest payment dates having passed since the date of purchase and (i) in the case of a security purchased at a premium, by deducting the product thus obtained from the purchase price, and (ii) in the case of a security purchased at a discount, by adding the product thus obtained to the purchase price.

“Variable Rate Bonds” means any Subordinate Bonds issued bearing interest at a rate per annum subject to adjustment from time to time pursuant to the terms thereof, based upon an index, or otherwise calculated in a manner which precludes the actual rate for the entire term of such debt from being ascertainable in advance. For the purposes of this definition, Subordinate Bonds shall not be considered to be Variable Rate Bonds upon the establishment of or conversion of the rate of interest thereon to a fixed interest rate.

Allocation and Application of Revenues [Certificate Section 5.01]

For so long as any Bonds are Outstanding, (1) the State Highway Fund and the Highway Revenue Special Account shall both be continued and (2) all Revenues that are deposited in the State Highway Fund shall be immediately credited to the Highway Revenue Special Account. The Revenues credited or to be credited to the Highway Revenue Special Account shall be applied, used and disposed of as follows, and in the following order of priority:

FIRST: For further credit to the following subaccounts in the following order of priority in the amounts required pursuant to the provisions of the Certificate:

- (a) Highway Senior Interest Subaccount;
- (b) Highway Senior Principal Subaccount;
- (c) Highway Senior Debt Service Reserve Subaccount;

SECOND: For further credit to the following subaccounts in the following order of priority in the amounts required pursuant to the provisions of the Certificate:

- (d) Highway Subordinate Interest Subaccount;
- (e) Highway Subordinate Principal Subaccount; and
- (f) Highway Subordinate Debt Service Reserve Subaccount;

THIRD: For payment of Operation and Maintenance Expenses;

FOURTH: For payment of the costs of acquisition (including real property and interests therein), construction, addition, expansion, improvement, renewal, replacement, reconstruction, engineering, investigation, and planning for the Undertaking and bikeways, all or any of which in the judgment of the Department are necessary to the performance of its duties or functions;

FIFTH: To reimburse the general fund of the State for Reimbursable General Obligation Bonds;

SIXTH: All or any portion of available moneys credited to the Highway Revenue Special Account, after satisfying the requirements of priority items FIRST through FIFTH above, determined in conformance with Section 248-9, Hawaii Revised Statutes, as amended, or any successor statute thereto, by the Director of Transportation to be in excess of 135% of the requirements for the ensuing 12 months for the Highway Revenue Special Account, or such other percentage of such requirements as may be authorized by law, may be transferred from the Highway Revenue Special Account as permitted by and in accordance with Section 37-53, Hawaii Revised Statutes, as amended, or any successor statute thereto; and

SEVENTH: To provide funds for other special reserve funds and other special funds as may be created by law.

Highway Senior Interest Subaccount [Certificate Section 5.02]

The moneys credited to the Highway Senior Interest Subaccount shall be disbursed solely for the purpose of paying interest on the Senior Bonds as the same becomes due. In each month, commencing with the first Business Day of the month which follows the last month for which interest on a Series of Senior Bonds, if any, is provided for from the proceeds of a Series of Senior Bonds, commencing on such first Business Day and continuing on the first Business Day of each month thereafter so long as any of the Senior Bonds of such Series are Outstanding, the Department shall credit to the Highway Senior Interest Subaccount from amounts credited to the Highway Revenue Special Account an amount such that, if the same amount were so credited on the first Business Day of each succeeding month thereafter, the aggregate of such amounts credited on the first Business Day of the month preceding an Interest Payment Date will be equal to the installment of interest falling due on the Senior Bonds on such Interest Payment Date or the amount required to reimburse the Support Facility provider for a draw on the Support Facility made to provide funds for the payment thereof. In making the credits to the Highway Senior Interest Subaccount required by this paragraph, consideration shall be given to and allowance made for accrued

interest received upon the sale of a Series of Senior Bonds, and for interest capitalized from the proceeds of a Series of Senior Bonds (which accrued or capitalized interest shall in each case be deposited in the Highway Revenue Special Account for credit to the Highway Senior Interest Subaccount), and for any other credits otherwise made to said account.

Highway Senior Principal Subaccount [Certificate Section 5.03]

In the event of the issuance of any Senior Bonds under the Certificate in the form customarily known as “serial bonds,” in order to provide for the payment of principal of such Senior Bonds of such Series, or to reimburse the Support Provider for a draw on the Support Facility made to provide funds for the payment of such Senior Bonds maturing serially, commencing with the month which is 12 months prior to the first principal payment date of any of such Senior Bonds maturing serially and in each month thereafter so long as any of such Senior Bonds so maturing are Outstanding, there shall be credited to the Highway Senior Principal Subaccount an amount such that, if the same amount were so credited to this account on the first Business Day of such first month and each succeeding month thereafter prior to the next date upon which the principal of any of said Senior Bonds maturing serially becomes due and payable, the aggregate of the amounts on credit will on the first Business Day of the month preceding each such next principal payment date be equal to the principal amount of said Senior Bonds becoming due on such principal payment date.

In the event of the issuance of any Senior Bonds under the Certificate in the form customarily known as “term bonds”, for the purpose of retiring such Senior Bonds, or to reimburse the Support Provider for a draw on the Support Facility made to provide funds for the payment of such term Senior Bonds, commencing with the month which is 12 months immediately prior to the date upon which the first Sinking Fund Installment to provide for the retirement of such term Senior Bonds is due, and in each month thereafter so long as any of such Senior Bonds are Outstanding, there shall be credited to the Highway Senior Principal Subaccount from amounts credited to the Highway Revenue Special Account an amount such that, if the same amount were so credited on the first Business Day of such first month and each succeeding month thereafter prior to the next date upon which a Sinking Fund Installment falls due, the aggregate of the amounts so credited will on the first Business Day of the month preceding each such next date upon which a Sinking Fund Installment falls due be sufficient to redeem the term Senior Bonds of each Series in the principal amounts and at the times specified in the Supplemental Certificate authorizing the issuance thereof.

The amounts of moneys credited to the Highway Senior Principal Subaccount for the purpose of providing for the retirement of Senior Bonds issued in the form of term bonds shall be applied by the Director of Finance, without further authorization or direction, to the redemption of the Senior Bonds of a Series on each date on which a Sinking Fund Installment for said Series of Senior Bonds is due in the respective principal amounts required to be credited on such dates, or, if so directed by the Department, commencing with respect to each Series of Senior Bonds with the second Sinking Fund Installment for each such Series, semi-annually on both such due date and the day six months prior to such due date so that the aggregate amount so applied in each calendar year will equal the respective principal amount required to be credited on such Sinking Fund Installment date. The Director of Finance shall give notice of a such redemptions, in the name and on behalf of the State, in accordance with the provisions of Article III of the Certificate. The Director of Finance may also, without further authorization or direction, apply the moneys credited to the Highway Senior Principal Subaccount for the retirement of term Senior Bonds of a Series to the purchase of said Senior Bonds; provided, however, that no Senior Bonds shall be purchased during the interval between the date on which notice of redemption of said Senior Bonds from Sinking Fund Installments for such Series is given and the date of redemption set forth in such notice, unless the Senior Bonds so purchased are Senior Bonds called for redemption in such notice or are purchased from moneys other than those credited to the Highway Senior Principal Subaccount for such Series, and provided further, that no purchases of Senior Bonds shall be made if such purchase would require the sale at a loss of securities credited to the Highway Senior Principal Subaccount unless the difference between the actual purchase price (including accrued interest and any brokerage or other charge) paid for such Senior Bonds and the then maximum purchase price (plus accrued interest) permitted to be paid therefor, is greater than the loss upon the sale of any such securities. Any purchase of Senior Bonds as described in this paragraph may be made with or without tenders of Senior Bonds and at either public or private sale, but in any event at a purchase price (including accrued interest and any brokerage or other charge) not to exceed the then applicable Redemption Price, plus accrued interest. All Senior Bonds purchased or redeemed as described in this paragraph shall be canceled and not reissued.

If the principal amount of Senior Bonds purchased and retired through application of any Sinking Fund Installment shall exceed the amount of such Sinking Fund Installment, or in the event of the purchase or redemption of Senior Bonds of any Series and maturity for which Sinking Fund Installments have been established from moneys other than Sinking Fund Installments, such excess or the principal amount of Senior Bonds so purchased or redeemed, as the case may be, shall be credited toward future Sinking Fund Installments either (i) in order of their due dates or (ii) in such order as the Department establishes in a Certificate of the Director of Transportation and delivered to the Registrar on or prior to the forty-fifth day preceding the next Sinking Fund Installment due date established for such Senior Bonds.

Highway Senior Debt Service Reserve Subaccount [Certificate Section 5.05]

(a) There is created in the Highway Revenue Special Account a “Highway Senior Debt Service Reserve Subaccount,” which shall be maintained in an amount equal to the Reserve Requirement and shall be disbursed solely for the purpose of paying principal of and interest on Senior Bonds for the payment of which there shall be insufficient money in the Highway Senior Interest Subaccount or Highway Senior Principal Subaccount. The Reserve Requirement shall be determined at the time of issuance of a Series of Senior Bonds, the deposit therein of any Support Facility, July 1 of each year and such other time or times as the Department shall determine and shall be funded upon the issuance of each Series of Senior Bonds.

(b) Subject to the remaining provisions as described under this caption “Highway Senior Debt Service Reserve Subaccount,”

(i) if at any time during a Fiscal Year the moneys on credit to the Highway Senior Debt Service Reserve Subaccount are less than the Reserve Requirement (including any deficiency in any Reserve Fund Facility), the amount of the deficiency shall be restored from the first available Pledged Funds (after making the deposits and credits required by the Certificate);

(ii) if at the end of any Fiscal Year, the moneys (taking into account the amount then available to be drawn under any Reserve Fund Facility) credited to the Highway Senior Debt Service Reserve Subaccount are less than the Reserve Requirement, the Department shall (after making the deposits and credits required by the Certificate) credit an amount to the Highway Senior Debt Service Reserve Subaccount from Pledged Funds credited to the Highway Revenue Special Account so that there shall then be credited to the Highway Senior Debt Service Reserve Subaccount an amount equal to the Reserve Requirement;

(iii) if the deficiency in the Highway Senior Debt Service Reserve Subaccount is due to the application of moneys credited thereto (or payments under any Reserve Fund Facility) to pay principal of or interest on any Senior Bonds, then in each month, commencing with the month which follows the month in which such application or payment is made from the Highway Senior Debt Service Reserve Subaccount, the Department shall (after making the deposits and credits required by the Certificate) credit from the Pledged Funds credited to the Highway Revenue Special Account to the Highway Senior Debt Service Reserve Subaccount the greater of (A) 1/12th of the aggregate Reserve Fund Facility Costs relating to each draw under any Reserve Fund Facility, which moneys shall be used by the Department to pay Reserve Fund Facility Costs or (B) an amount which, if the same amount were so credited in each month thereafter until such day as the Department shall determine, which day shall not be more than 60 months from the making of the first of such credits there shall be credited to such Subaccount on such day an amount not less than the Reserve Requirement;

(iv) if at any time and for so long as the moneys credited to the Highway Senior Debt Service Reserve Subaccount are at least equal to the Reserve Requirement and all Reserve Fund Facility Costs have been paid, then no further credits shall be made to such Subaccount, and any amounts in excess of the Reserve Requirement may be retained in the Highway Revenue Special Account for use and application as are all other moneys on deposit therein; and

(v) Any Reserve Fund Facility Costs shall be paid by the Department from amounts deposited into the Highway Senior Debt Service Reserve Subaccount to the account specified in writing to the Department by the applicable Reserve Facility Issuer.

(c) When Senior Bonds are refunded in whole or in part or are otherwise paid so that all or a portion of the Senior Bonds are no longer Outstanding and no Reserve Fund Facility Costs are unpaid, then moneys credited to the Highway Senior Debt Service Reserve Subaccount in excess of the Reserve Requirement may be withdrawn from the Highway Revenue Special Account to pay or provide for the payment of such Senior Bonds or refunded Senior Bonds, as the case may be, or may be transferred and applied by the Department to any other subaccount in the Highway Revenue Special Account to the extent of any deficiency therein or to any other account in the State Highway Fund, in accordance with instructions of the Director or pursuant to law; provided that immediately after such withdrawal or transfer there shall be on credit to the Highway Senior Debt Service Reserve Subaccount an amount equal to the Reserve Requirement.

(d) In lieu of the credit of moneys to the Highway Senior Debt Service Reserve Subaccount, the Department may cause to be so credited one or more Support Facilities in an amount equal to the difference between the Reserve Requirement and the aggregate of (i) the amounts then credited to the Highway Senior Debt Service Reserve Subaccount and (ii) the amounts then available to be drawn under any Reserve Fund Facility then credited to such Subaccount. In the event a Support Facility is obtained to satisfy a portion of the Reserve Requirement, so long as such Support Facility is in effect, to the extent that there are moneys (or Investment Securities) on deposit in such Subaccount, such moneys shall be used (and such Investment Securities liquidated and proceeds used) to make deposits to as described under the Certificate prior to any drawings under any Reserve Fund Facility therein. The Support Facility shall be payable (upon the giving of notice as required under the Certificate) on any date on which moneys will be required to be applied from the Highway Senior Debt Service Reserve Subaccount to the payment of the principal of or interest on any Senior Bonds. Prior to the use of a Support Facility pursuant to the provisions under this caption "Highway Senior Debt Service Reserve Subaccount" (other than any such use at the time of issuance of the Bonds), the Department shall receive written confirmation from the Rating Agency that the rating on the Senior Bonds Outstanding as then in effect shall not be reduced as a result of such use.

If a disbursement is made pursuant to a Support Facility provided pursuant to provisions under this caption "Highway Senior Debt Service Reserve Subaccount," the Department shall be obligated either (i) to reinstate the maximum limits of such Support Facility or (ii) to credit to the Highway Senior Debt Service Reserve Subaccount, funds in the amount of the disbursement made under such Support Facility, or a combination of such alternatives, as shall provide that the amount credited to the Highway Senior Debt Service Reserve Subaccount equals the Reserve Requirement for the Senior Bonds; provided, however, a failure to immediately restore such Reserve Requirement shall not constitute an Event of Default if the Reserve Requirement is restored within the time period permitted by paragraph (b) above. Notwithstanding the provisions of paragraph (b) above, the Department shall not permit any Support Facility which has been established in lieu of a deposit into the Highway Revenue Special Account for credit to the Highway Senior Debt Service Reserve Subaccount to terminate or expire prior to depositing to such Subaccount for credit to such Subaccount the amount satisfied previously by such Support Facility.

Highway Subordinate Interest Subaccount [Certificate Section 5.06]

Moneys on credit to the Highway Subordinate Interest Subaccount shall be disbursed solely for the purpose of paying interest on the Subordinate Bonds as the same becomes due. In each month, commencing with the first Business Day of the month which follows the last month for which interest on a Series of Subordinate Bonds, if any, is provided for from the proceeds of a Series of Subordinate Bonds, (a) with respect to each Series of Subordinate Bonds (other than Variable Rate Subordinate Bonds which have Interest Payment Dates occurring at intervals of one month or less), commencing on such first Business Day and continuing on the first Business Day of each month thereafter so long as any of the Subordinate Bonds of such Series are Outstanding, the Department shall credit to the Highway Subordinate Interest Subaccount from amounts credited to the Highway Revenue Special Account an amount such that, if the same amount were so credited on the first Business Day of each succeeding month thereafter, the aggregate of such amounts credited on the first Business Day of the month preceding an Interest Payment Date will be equal to the installment of interest falling due on the Subordinate Bonds on such Interest Payment Date or the amount required to reimburse the Support Facility provider for a draw on the Support Facility made to provide funds for the payment thereof, and (b) with respect to Variable Rate Subordinate Bonds which have

Interest Payment Dates occurring at intervals of one month or less, on the first Business Day of the month prior to each Interest Payment Date the Department shall credit to the Highway Subordinate Interest Subaccount from amounts credited to the Highway Revenue Special Account the amount required together with other funds available therefor credited to such account, to pay, or to reimburse the Support Facility provider for a draw on the Support Facility made to provide funds for the payment of, the interest payable on such Interest Payment Date or Dates on the Outstanding Variable Rate Subordinate Bonds. In making the credits to the Highway Subordinate Interest Subaccount required by this paragraph, consideration shall be given to and allowance made for accrued interest received upon the sale of a Series of Subordinate Bonds, and for interest capitalized from the proceeds of a Series of Subordinate Bonds (which accrued or capitalized interest shall in each case be deposited in the Highway Revenue Special Account for credit to the Highway Subordinate Interest Subaccount), and for any other credits otherwise made to said account. Variable Rate Subordinate Bonds shall be assumed to bear interest at the assumed interest rate as determined pursuant to the Certificate, and monthly credits made with respect to Variable Rate Subordinate Bonds shall be adjusted to the extent possible to reflect the actual interest rate on Variable Rate Subordinate Bonds in the preceding month so that, as of any Interest Payment Date, the amount available is sufficient to pay the interest then due; provided, however, that any payments to a Support Provider pursuant to a Support Agreement as Holder of a Subordinate Bond which are in excess of the stated rate of interest on such Subordinate Bond, whether denominated additional interest, penalty rate, or otherwise, shall not constitute interest for purposes of this paragraph.

Highway Subordinate Principal Subaccount [Certificate Section 5.07]

In the event of the issuance of any Series of Subordinate Bonds under the Certificate in the form customarily known as “serial bonds”, in order to provide for the payment of principal of such Subordinate Bonds of such Series, or to reimburse the Support Provider for a draw on the Support Facility made to provide funds for the payment of such Subordinate Bonds maturing serially, commencing with the month which is 12 months prior to the first principal payment date of any of such Subordinate Bonds maturing serially and in each month thereafter so long as any of such Subordinate Bonds so maturing are Outstanding, there shall be credited to the Highway Subordinate Principal Subaccount an amount such that, if the same amount were so credited to this account on the first Business Day of such first month and each succeeding month thereafter prior to the next date upon which the principal of any of said Subordinate Bonds maturing serially becomes due and payable, the aggregate of the amounts on credit will on the first Business Day of the month preceding each such next principal payment date be equal to the principal amount of said Subordinate Bonds becoming due on such principal payment date.

In the event of the issuance of any Subordinate Bonds under the Certificate in the form customarily known as “term bonds,” for the purpose of retiring such Subordinate Bonds, or to reimburse the Support Facility provider for a draw on the Support Facility made to provide funds for the payment of such term Subordinate Bonds, commencing with the month which is 12 months immediately prior to the date upon which the first Sinking Fund Installment to provide for the retirement of such term Subordinate Bonds is due, and in each month thereafter so long as any of such Subordinate Bonds are Outstanding, there shall be credited to the Highway Subordinate Principal Subaccount from amounts credited to the Highway Revenue Special Account an amount such that, if the same amount were so credited on the first Business Day of such first month and each succeeding month thereafter prior to the next date upon which a Sinking Fund Installment falls due, the aggregate of the amounts so credited will on the first Business Day of the month preceding each such next date upon which a Sinking Fund Installment falls due be sufficient to redeem the term Subordinate Bonds of each Series in the principal amounts and at the times specified in the Supplemental Certificate authorizing the issuance thereof.

The amounts of moneys credited to the Highway Subordinate Principal Subaccount for the purpose of providing for the retirement of Subordinate Bonds issued in the form of term bonds shall be applied by the Director of Finance, without further authorization or direction, to the redemption of the Subordinate Bonds of a Series on each date on which a Sinking Fund Installment for said Series of Subordinate Bonds is due in the respective principal amounts required to be credited on such dates, or, if so directed by the Department, commencing with respect to each Series of Subordinate Bonds with the second Sinking Fund Installment for each such Series, semi-annually on both such due date and the day six months prior to such due date so that the aggregate amount so applied in each calendar year will equal the respective principal amount required to be credited on such Sinking Fund Installment dates. The Director of Finance shall give notice of all such redemptions, in the name and on behalf of the State, in accordance with the provisions of Article III of the Certificate. The Director of Finance may also,

without further authorization or direction, apply the moneys credited to the Highway Subordinate Principal Subaccount for the retirement of term Subordinate Bonds of a Series to the purchase of said Subordinate Bonds; provided, however, that no Subordinate Bonds shall be purchased during the interval between the date on which notice of redemption of said Subordinate Bonds from Sinking Fund Installments for such Series is given and the date of redemption set forth in such notice, unless the Subordinate Bonds so purchased are Subordinate Bonds called for redemption in such notice or are purchased from moneys other than those credited to the Highway Subordinate Principal Subaccount for such Series, and provided further, that no purchases of Subordinate Bonds shall be made if such purchase would require the sale at a loss of securities credited to the Highway Subordinate Principal Subaccount unless the difference between the actual purchase price (including accrued interest and any brokerage or other charge) paid for such Subordinate Bonds and the then maximum purchase price (plus accrued interest) permitted to be paid therefor, is greater than the loss upon the sale of any such securities. Any purchase of Subordinate Bonds as described in this paragraph may be made with or without tenders of Subordinate Bonds and at either public or private sale, but in any event at a purchase price (including accrued interest and any brokerage or other charge) not to exceed the then applicable Redemption Price, plus accrued interest. All Subordinate Bonds purchased or redeemed as described in this paragraph shall be canceled and not reissued.

If the principal amount of Subordinate Bonds purchased and retired through application of any Sinking Fund Installment shall exceed the amount of such Sinking Fund Installment, or in the event of the purchase or redemption of Subordinate Bonds of any Series and maturity for which Sinking Fund Installments have been established from moneys other than Sinking Fund Installments, such excess or the principal amount of Subordinate Bonds so purchased or redeemed, as the case may be, shall be credited toward future Sinking Fund Installments either (i) in order of their due dates or (ii) in such order as the Department establishes in a Certificate of the Director of Transportation and delivered to the Registrar on or prior to the forty-fifth day preceding the next Sinking Fund Installment due date established for such Subordinate Bonds.

Highway Subordinate Debt Service Reserve Account [Certificate Section 5.09]

The Highway Subordinate Debt Service Reserve Account shall be maintained in an amount equal to the Reserve Requirement and shall be disbursed solely for the purpose of paying principal of and interest on Subordinate Bonds for the payment of which there shall be insufficient money in the Highway Subordinate Interest Subaccount or Highway Subordinate Principal Subaccount. The Reserve Requirement shall be determined at the time of issuance of a Series of Subordinate Bonds, July 1 of each year, at the time any Variable Rate Subordinate Bonds of a Series cease to be Variable Rate Subordinate Bonds, and such other time or times as the Department shall determine and shall be funded upon the issuance of each Series of Subordinate Bonds.

Subject to the remaining provisions described under this caption, (a) if at any time during a Fiscal Year the moneys on credit to the Highway Subordinate Debt Service Reserve Subaccount are less than the Reserve Requirement (including any deficiency in a Support Facility used to fund all or a portion of the Reserve Requirement), the amount of the deficiency shall be restored from the first available Pledged Funds; (b) if at the end of any Fiscal Year, the moneys credited to the Highway Subordinate Debt Service Reserve Subaccount are less than the Reserve Requirement, the Department shall (after making the deposits and credits to other subaccounts and purposes as required by the Certificate) credit an amount to the Highway Subordinate Debt Service Reserve Subaccount from Pledged Funds credited to the Highway Revenue Special Account so that there shall then be credited to the Highway Subordinate Debt Service Reserve Subaccount an amount equal to the Reserve Requirement; (c) if the deficiency in the Highway Subordinate Debt Service Reserve Subaccount is due to the application of moneys credited thereto to pay principal of or interest on a Series of Subordinate Bonds, then in each month, commencing with the month which follows the month in which such application is made from the Highway Subordinate Debt Service Reserve Subaccount, the Department shall (after making the deposits and credits to other subaccounts and purposes as required by the Certificate) credit from the Pledged Funds credited to the Highway Revenue Special Account to the Highway Subordinate Debt Service Reserve Subaccount an amount which, if the same amount were so credited in each month thereafter until such day as the Department shall determine, which day shall not be more than 60 months from the making of the first of such credits, there shall be credited to such account on such day an amount not less than the Reserve Requirement; and (d) if at any time and for so long as the moneys credited to the Highway Subordinate Debt Service Reserve Subaccount are at least equal to the Reserve Requirement, no further credits shall be made to the account, and any amounts in excess of the Reserve Requirement

may be retained in the Highway Revenue Special Account for use and application as are all other moneys on deposit therein.

When a Series of Subordinate Bonds is refunded in whole or in part or is otherwise paid so that all of the Subordinate Bonds of such Series are no longer Outstanding, moneys credited to the Highway Subordinate Debt Service Reserve Subaccount may be withdrawn from the Highway Revenue Special Account to pay or provide for the payment of such Subordinate Bonds or refunded Subordinate Bonds, as the case may be, or may be transferred and applied to any reserve fund or account established for the Refunding Subordinate Bonds issued to refund such refunded Subordinate Bonds; provided that immediately after such withdrawal or transfer there shall be on credit to the Highway Subordinate Debt Service Reserve Subaccount an amount equal to the Reserve Requirement.

In lieu of the credit of moneys to the Highway Subordinate Debt Service Reserve Subaccount, the Department may cause to be so credited a Support Facility in an amount equal to the difference between the Reserve Requirement and the amounts then credited to the Highway Subordinate Debt Service Reserve Subaccount. In the event a Support Facility is obtained to satisfy a portion of the Reserve Requirement allocable to a Series of Subordinate Bonds, so long as such Support Facility is in effect, the Owners of such Series of Subordinate Bonds shall not be entitled to payment from or a lien on the funds credited to the Highway Revenue Special Account credited to the Highway Subordinate Debt Service Account to satisfy that portion of the Reserve Requirement allocable to other Series of Subordinate Bonds, nor shall the Owners of Subordinate Bonds of such other Series be entitled to any payment from such Support Facility. The Support Facility shall be payable (upon the giving of notice as required thereunder) on any date on which moneys will be required to be applied from the Highway Subordinate Debt Service Reserve Subaccount to the payment of the principal of or interest on any Subordinate Bonds of such Series and such withdrawals may not be made from amounts credited to the Highway Subordinate Debt Service Reserve Subaccount for such Series of Subordinate Bonds. Prior to the use of a Support Facility pursuant to the provisions of this paragraph, the Department shall receive written confirmation from the Rating Agency that the rating on the Subordinate Bonds Outstanding as then in effect shall not be reduced as a result of such use. If a disbursement is made pursuant to a Support Facility provided pursuant to this paragraph, the Department shall be obligated either (i) to reinstate the maximum limits of such Support Facility or (ii) to credit to the Highway Subordinate Debt Service Reserve Subaccount, funds in the amount of the disbursement made under such Support Facility, or a combination of such alternatives, as shall provide that the amount credited to the Highway Subordinate Debt Service Reserve Subaccount allocable to a Series of Subordinate Bonds equals that portion of the Reserve Requirement allocable to such Series; provided, however, a failure to immediately restore such Reserve Requirement shall not constitute an Event of Default if the Reserve Requirement is restored within the time period described in clause (b) under "Events of Default; Remedies—Events of Default" below. Notwithstanding the provisions of said clause (b), the Department shall not permit any Support Facility which has been established in lieu of a deposit into the Highway Revenue Special Account for credit to the Highway Subordinate Debt Service Reserve Subaccount to terminate or expire prior to depositing to such fund for credit to such account the amount satisfied previously by the Support Facility.

Investment of Moneys [Certificate Section 5.10]

Moneys in the Highway Revenue Special Account credited to the Highway Senior Interest Subaccount, the Highway Senior Principal Subaccount, the Highway Subordinate Interest Subaccount, and the Highway Senior Subordinate Principal Subaccount therein shall be invested by the Director of Finance in Investment Securities which have ratings provided by Moody's and S&P that are not less than the ratings given to the Senior Bonds then Outstanding and which mature in such amounts and at such times so that the principal of and interest and premium, if any, on the Bonds can be paid when due, whether at maturity or upon the redemption thereof. Moneys in the Highway Revenue Special Account credited to the Highway Senior Debt Service Reserve Subaccount and the Highway Subordinate Debt Service Reserve Subaccount therein shall be invested by the Director of Finance in Federal Securities which have ratings provided by Moody's and S&P that are not less than the ratings given to the Senior Bonds then Outstanding and which have maturities or are redeemable at the option of the Holder thereof in not more than 5 years from the date of investment, but in any event by no later than the last or final maturity date of the Senior Bonds or Subordinate Bonds then Outstanding, as the case may be. The Department in the Certificate grants its approval for all investments made by the Director of Finance pursuant to the Certificate, and no further approvals of the Department shall be necessary therefor.

Income derived from investments made pursuant to the foregoing provisions of the Certificate shall be treated as Revenues; expenses of purchase, safekeeping, sale and redemption, and all other expenses attributable to such investments shall be proper expenses of the Undertaking. Investment Securities so purchased shall be considered as being deposited in the custody or control of the Director of Finance by the Department.

All moneys in the Highway Revenue Special Account and the Highway Bond Proceeds Account, the investment of which is not otherwise provided for in the Certificate, may be invested, and the income from such investments disbursed or applied, as may be provided by applicable law.

All securities shall constitute a part of the respective fund or account from which the investment therein was made. For the purposes of making any calculations or computations at any time and from time to time of the amounts in the State Highway Fund, or any fund or account therein, which may be required for the purposes of the Certificate, the Value of Investment Securities shall be determined at the time of any withdrawal therefrom and as of July 1 of each year.

The Department will maintain records to enable it to cause to be made the computations necessary to determine whether a Series of Bonds the interest on which is intended to be excludable from gross income for federal income tax purposes meets the requirements of Section 148 of the Code, including, but not limited to, records showing the dates and amounts of all investments of funds credited to a subaccounts in the Highway Revenue Special Account and the Highway Bond Proceeds Account.

Revenues Held in Trust, Lien of Bondholders [Certificate Section 5.11]

The moneys in the State Highway Fund shall be, until used, applied and disbursed in accordance with the provisions of the Certificate, held in trust: (i) for the equal benefit and security of the Holders from time to time of the Senior Bonds; and (ii) subject to the prior and senior rights, benefits and security of the Holders from time to time of the Senior Bonds, for the equal benefit and security of the Holders from time to time of the Subordinate Bonds. Subject to the provisions of the Certificate relating to application of moneys, all Senior Bonds shall have a prior and paramount lien on the Revenues paid into the Highway Revenue Special Account for credit to the Highway Senior Interest Subaccount, the Highway Senior Principal Subaccount and the Highway Senior Debt Service Reserve Subaccount therein and the investments in which such Revenues may from time to time be invested, over and ahead of all Subordinate Bonds and all bonds, notes or other evidences of indebtedness which may subsequently be issued, and over and ahead of any claims, encumbrances or obligations subsequently arising or subsequently incurred, and all the Senior Bonds shall be equally and ratably secured, without priority by reason of series, number, date of execution or of any Supplemental Certificate providing for the issuance thereof, date of Senior Bonds, date of issuance, date of sale, date of execution, date of authentication, or date of delivery, by such lien in accordance with the provisions of the Certificate. Subject to the prior and paramount lien provided in the preceding sentence in respect of the Senior Bonds and further subject to the provisions of the Certificate relating to application of moneys, all Subordinate Bonds shall have a lien on the Revenues paid into the Highway Revenue Special Account for credit to the Highway Subordinate Interest Subaccount, the Highway Subordinate Principal Subaccount and the Highway Subordinate Debt Service Reserve Subaccount therein and the investments in which such Revenues may from time to time be invested, over and ahead of all bonds, notes or other evidences of indebtedness which may subsequently be issued, and over and ahead of any claims, encumbrances or obligations subsequently arising or subsequently incurred, and all the Subordinate Bonds shall be equally and ratably secured, without priority by reason of series, number, date of execution or of any Supplemental Certificate providing for the issuance thereof, date of Subordinate Bonds, date of issuance, date of sale, date of execution, date of authentication, or date of delivery, by such lien in accordance with the provisions of the Certificate. Subject to the provisions of the Certificate relating to application of moneys, no claim, encumbrance or obligation against the Pledged Funds subsequently arising or incurred shall be secured by or entitled to a lien or charge thereon prior to or equal with the payments required by the Certificate to be made from the Pledged Funds to provide for the payment of the Bonds.

Conditions Precedent to Issuance of Additional Bonds and Refunding Bonds [Certificate Section 4.02]

The Department at any time and from time to time may authorize the issuance of one or more Series of: (i) additional Senior Bonds (“Additional Senior Bonds”) or refunding Senior Bonds (“Refunding Senior Bonds”) payable from the Highway Revenue Special Account on a parity with all other Senior Bonds then Outstanding and

equally and ratably secured therewith, or (ii) additional Subordinate Bonds (“Additional Subordinate Bonds”) or refunding Subordinate Bonds (“Refunding Subordinate Bonds”) payable from the Highway Revenue Special Account on a parity with any Additional Subordinate Bonds or Refunding Subordinate Bonds then Outstanding and equally and ratably secured therewith, in each case upon compliance with the following conditions:

1. The issuance of the Additional Bonds or Refunding Bonds shall have been authorized by law as confirmed by an Opinion of Counsel and are issued under and pursuant to a Supplemental Certificate or Certificates.

2. The Supplemental Certificate providing for the issuance of such Bonds shall provide that any accrued interest received upon the sale of said Bonds or any interest capitalized from the proceeds of said Bonds shall be paid into the Highway Revenue Special Account for credit to the Highway Senior Interest Subaccount or the Highway Subordinate Interest Subaccount;

3. At the time of the issuance of such Bonds, no default exists in the payment of the principal of and premium, if any, and interest on any Bond; no deficiencies exist in the State Highway Fund or the Highway Revenue Special Account; and there does not exist an “Event of Default” or a condition which upon the passage of time would constitute such an “Event of Default”;

4. Upon the delivery of such Bonds, there shall be credited to the Highway Revenue Special Account for credit to the Highway Senior Debt Service Reserve Subaccount and the Highway Subordinate Debt Service Reserve Subaccount an amount equal to, in each case, the Reserve Requirement; provided however, that the Supplemental Certificate providing for the issuance of such Series of Bonds may provide that part of the proceeds thereof shall be paid or a Support Facility may be deposited, into the Highway Revenue Special Account for credit to the Highway Senior Debt Service Reserve Subaccount or the Highway Subordinate Debt Service Reserve Subaccount, as the case may be.

5. In the case of the issuance of Additional Bonds, upon compliance with the additional conditions summarized below under the heading “Additional Conditions for the Issuance of Additional Bonds.”

6. In the case of the issuance of Refunding Bonds, upon compliance with the additional conditions summarized below under the heading “Additional Conditions for the Issuance of Refunding Bonds.”

Additional Conditions for the Issuance of Additional Bonds [Certificate Section 4.03]

Each of the following conditions, in addition to those set forth above under the heading “Conditions Precedent to Issuance of Additional Bonds and Refunding Bonds,” be met upon the issuance of Additional Bonds:

(a) Such Bonds shall be issued only for the purpose of the payment or reimbursement of the cost of the acquisition or construction of properties to constitute part of the Undertaking or the making of additions to, expansions of, improvements of, renewals of, replacements of, or reconstructions of, the Undertaking or of properties which shall constitute part of the Undertaking; and

(b) The Revenues for any 12 consecutive calendar month’s period out of the last eighteen (18) consecutive calendar month’s period immediately preceding the date of issuance of the Series of Bonds, as derived from the most recent publicly available financial statements of the Department, shall be at least equal to: (i) in the case of Senior Bonds proposed to be issued, two (2) times maximum Aggregate Bond Service for any future Fiscal Year on a Senior Bonds to be Outstanding after the issuance of such Additional Senior Bonds; and (ii) in the case of Subordinate Bonds proposed to be issued, one and thirty-hundredths (1.30) times maximum Aggregate Bond Service for any future Fiscal Year on all Bonds to be Outstanding after the issuance of such Additional Subordinate Bonds.

Additional Conditions for the Issuance of Refunding Bonds [Certificate Section 4.04]

The following conditions, in addition to those set forth above under “Conditions Precedent to Issuance of Additional Bonds and Refunding Bonds,” shall be met upon the issuance of Refunding Bonds:

- (a) Such Refunding Bonds are being issued for the purpose of refunding at their maturity or at any time within one year prior to their maturity, any of the then Outstanding Bonds, for the payment of which sufficient funds are not available, which Bonds to be refunded shall be specified in the Supplemental Certificate providing for the issuance of the Refunding Bonds; and
- (b) Refunding Bonds may be issued to refund prior to maturity all or part of the Outstanding Bonds, including therein amounts to pay principal of, and redemption and acquisition premium and interest on the Bonds to be refunded, which Bonds to be refunded shall be specified in the Supplemental Certificate providing for the issuance of the Refunding Bonds.

Variable Rate Bonds [Certificate Section 4.02]

Nothing in the Certificate shall prohibit or prevent, or be deemed or construed to prohibit or prevent, the Department from issuing Variable Rate Bonds; provided, however, that no Variable Rate Bond may be issued as a Senior Bond. The Supplemental Certificate providing for the issuance of such Variable Rate Bonds may provide for, without limitation, the following: Support Facilities or alternative Support Facilities and support agreements in connection therewith; remarketing agreements and the appointment of remarketing agents; the appointment of tender agents to accept mandatory or optional tenders of Variable Rate Bonds; the payment, redetermination and accrual over specified periods of interest; the establishment, use, composition, adjustment and change of interest indices or modes or the establishment and use of alternative interest indices or modes or the establishment of a fixed interest rate or rates; the establishment of special funds and accounts in connection with the issuance of such Variable Rate Bonds; special redemption or purchase provisions for such Variable Rate Bonds and notice provisions in connection with the purchase, redemption, delivery or tender of such Variable Rate Bonds; and any other terms and provisions not in conflict with the Certificate.

Annual Audit [Certificate Section 6.04]

The Department shall maintain and keep, or cause to be maintained and kept, proper books, records and accounts in which complete and correct entries shall be made of all dealings and transactions relating to the Undertaking. Such accounts shall show the amount of the Revenues and the application of such Revenues to the purposes specified in the Certificate and all financial transactions in connection therewith, including all deposits into and disbursements from the State Highway Fund, the Highway Revenue Special Account and the Highway Bond Proceeds Account.

The Department shall cause its accounts to be audited by an accountant (herein defined and referred to as the “Independent Public Accountant”) employed by it, such period of appointment or employment to be from year to year. Such Independent Public Accountant shall be selected with special reference to his general knowledge, skill and experience in auditing books and accounts, and shall be a certified or licensed accountant or firm of certified or licensed accountants who, or each of whom, is in fact independent and not under the domination of the State (including the Department) and who, or each of whom, is not connected with the State (including the Department) as an officer or employee thereof, but who may be regularly retained to make annual or similar audits of any of the books of the State (including the Department). Such audit shall be made annually and shall be completed within 270 days after the close of each Fiscal Year, shall include a detailed statement of the Revenues and the expenditure and application thereof for such year and a detailed balance sheet of the Undertaking as of the close of such year, including therein a statement of the State Highway Fund and the Highway Revenue Special Account and accounts therein, and be accompanied in writing by a certificate of the Independent Public Accountant. Each such audit shall certify as to the correctness of the schedules contained in the audit report. A copy of each such annual audit shall be filed with the Director of Finance and shall be open for public inspection, and shall be mailed to any Holder of the Bonds filing with the Department a request for same. The cost of any such audit shall be an Operation and Maintenance Expense.

Annual Budget [Certificate Section 6.05]

The Department shall prepare and file with the proper officers of the State at the time and in the manner prescribed by law, an estimated budget of Revenues and Operation and Maintenance Expenses, Bond Service, capital improvements and any other proposed expenditures for the Undertaking for each Fiscal Year, which budgets shall be open to inspection by any Holder of Bonds or other interested party.

Amending Certificate Without Consent of Bondholders [Certificate Section 9.01]

The State, acting by and through the Department or as may otherwise then be provided by law, from time to time and at any time and without the consent or concurrence of the Holder of any Bond, may make and execute a Supplemental Certificate (i) for the purpose of providing for the issuance of Additional Bonds or the issuance of Refunding Bonds, (ii) to make any changes or modifications thereof, or amendments, additions or deletions thereto which may be required to permit the Certificate to be qualified under the Trust Indenture Act of 1939 of the United States of America, and (iii) if the provisions of such Supplemental Certificate shall not materially adversely affect the rights of the Holders of the Bonds then Outstanding, for any one or more of the following purposes:

1. To make any changes or corrections in the Certificate or any supplement thereto as to which it shall have been advised by its counsel that the same are minor clerical or typographical corrections or changes or are required for the purpose of curing or correcting any ambiguity or defective or inconsistent provision or omission or mistake or manifest error contained therein or in any such supplement thereto, or to insert in the Certificate such provisions clarifying matters or questions arising under the Certificate as are necessary or desirable;
2. To add additional covenants and agreements of the State for the purpose of further securing the payment of the Bonds, provided that such additional covenants and agreements are not contrary to or inconsistent with the covenants and agreements contained in the Certificate as originally issued or as amended with the consent of Bondholders;
3. To surrender any right, power or privilege reserved to or conferred upon the State by the terms of the Certificate or any supplement hereto;
4. To confirm as further assurance any lien, pledge or charge, or the subjection of any additional revenue, property or collateral to any lien, pledge or charge, created or to be created by the provisions of the Certificate or any supplement thereto;
5. To grant to or confer upon the Holders of the Bonds or any Support Provider, any additional rights, remedies, powers, authority or security that lawfully may be granted to or conferred upon them;
6. To prescribe further limitations and restrictions upon the issuance of Bonds and the incurring of indebtedness by the State payable from the Revenues;
7. To include any modifications, amendments or supplements as may be required with respect to any Series of Bonds in order to obtain a favorable rating or ratings from any Rating Agency;
8. To add or modify any provision of the Certificate as a result of enactment of any State or federal law which changes the treatment of the Bonds or interest thereon for tax purposes;
9. To include any modifications, amendments or supplements as may be required with respect to any Series of Bonds in order to permit such Series to be available through a book-entry system maintained by, or to be cleared through, The Depository Trust Company, New York, New York, or other securities depository, clearing corporation, or clearing agency;
10. To make any changes or corrections to the Certificate as are necessary to provide for the issuance of Bonds in a form not contemplated by the express provisions of the Certificate, including

without limitation in the form of commercial paper, indebtedness which converts from a variable rate to a fixed rate, indebtedness which initially compounds or accrues interest and then converts to a current interest-bearing instrument, and a Series of Bonds whereby the State pays a particular rate of interest and such interest payment is divided in a manner such that certain Bondholders receive a variable interest rate determined by the market and other Bondholders receive a residual interest rate approximating the difference between the interest payment paid by the State and such variable rate of interest; or

11. To modify, amend or supplement in any other respect any of the provisions of the Certificate, provided that such modifications shall have no adverse affect as to any Bond or Bonds which are then Outstanding.

Except for Supplemental Certificates providing for the issuance of Additional Bonds or Refunding Bonds, the State shall not make and execute any instrument or Certificate supplemental to the Certificate, unless in the Opinion of Counsel (which opinion may be combined with the Opinion required under the Certificate) the making and entering into of such instrument or such Supplemental Certificate is permitted by the provisions of the Certificate and the provisions of such instrument or of such Supplemental Certificate are not contrary to or inconsistent with the covenants or agreements of the State contained in the Certificate as originally issued or as amended with the consent of the Bondholders.

Amending Certificate With Consent of Bondholders [Certificate Section 9.02]

With the consent of the Holders of not less than a majority of the principal amount of the Bonds then Outstanding, the State, acting by and through the Department or as may otherwise then be provided by law, from time to time and at any time, may make and execute an instrument or certificate amending or supplementing the provisions of the Certificate for the purpose of adding any provisions to, or changing in any manner or eliminating any of the provisions of, the Certificate or of any supplement thereto, or modifying or amending the rights and obligations of the Department thereunder, or modifying in any manner the rights of the Holders of the Bonds; provided, however, that, without the specific consent of the Holder of each Bond which would be affected thereby, whether or not such Bond shall then be deemed to be Outstanding thereunder, no such instrument or certificate amending or supplementing the provisions thereof shall: (1) extend the fixed maturity date for the payment of the principal of any Bond, or reduce the principal amount of any Bond, or reduce the rate or extend the time of payment of interest thereon, or reduce any premium payable upon the redemption or prepayment thereof, or advance the date upon which any Bond may first be called for redemption prior to its fixed maturity date; (2) reduce the aforesaid percentage of Bonds, the Holders of which are required to consent to any such instrument or certificate amending or supplementing the provisions thereof; (3) give to any Bond or Bonds any preference over any other Bond or Bonds secured by the Certificate; (4) authorize the creation of any pledge of the Revenues or any lien or charge thereon prior or superior to or on a parity with the pledge of and lien and charge thereon created in the Certificate for the payment of the Bonds except to the extent provided in the Certificate; or (5) deprive any Holder of the Bonds of the pledge and lien created by the Certificate; and provided further, that if moneys or Federal Securities shall have been deposited in accordance with the provisions of the Certificate for the payment of particular Bonds and such Bonds shall not in fact have been paid, no amendments or supplements to the provisions of Article XI of the Certificate shall be made without the specific consent of the Holder of each Bond which would be affected thereby. A modification or amendment of the provisions of Article V of the Certificate with respect to any of the accounts therein shall not be deemed a change in the terms of payment of the Bonds; provided, however, that no such modification or amendment shall, except upon the consent of the Holders of all Bonds then Outstanding affected thereby, reduce the amount or amounts required to be deposited in the Highway Revenue Special Account for credit to all accounts therein.

Events of Default; Remedies [Certificate Sections 10.01 to 10.05]

Events of Default. The following shall constitute "Events of Default:"

(a) If payment of the interest on, or principal (including any Sinking Fund Installment) or premium (if any) of any Bond, whether at maturity or by proceedings for redemption, by declaration as described below, or otherwise, shall not be made after the same shall become due and payable; or

(b) If the Department shall default in the due and punctual performance of any of the covenants, conditions, agreements and provisions contained in the Bonds or in the Certificate or in any Certificate supplemental thereto, on the part of the Department to be performed, and such default shall continue for 90 days after written notice specifying such default and requiring the same to be remedied shall have been given to the Department by the Holders of not less than 20% in principal amount of the Bonds then Outstanding, or any trustee or committee therefor; provided, however, that if such failure shall be such that it cannot be corrected within such 90-day period, it shall not constitute an Event of Default if correction action is instituted within such period and diligently pursued until the failure is corrected; or

(c) If any proceedings shall be instituted, with the consent or acquiescence of the State, for the purpose of effecting a composition between the State and its creditors and if the claim of such creditors is in any circumstance payable from any of the Revenues or any other moneys pledged and charged in the Certificate or in any Certificate supplemental thereto, or for the purpose of adjusting the claims of such creditors, pursuant to any federal or State statute now or hereafter enacted; or

(d) If, under the provision of any other law for the relief or aid of debtors, any court of competent jurisdiction shall assume custody or control of the Undertaking or any of the buildings and facilities thereof, and such custody or control shall not be terminated within 90 days from the date of assumption of such custody or control; or

(e) If the Department or the State shall for any reason be rendered incapable of fulfilling its obligations under the Certificate.

Declaration of Principal and Interest as Due. Upon the occurrence and continuation of an Event of Default, then and in each and every case the Holders of not less than 25% in principal amount of the Senior Bonds then Outstanding and the Holders of not less than 25% in principal amount of the Subordinate Bonds then Outstanding may, by written notice to the Department filed in the office of the Department and with the Director of Finance, proceed to declare the principal of all Bonds then Outstanding, together with all accrued and unpaid interest thereon and together with all other moneys secured by the Certificate, if not already due, to be due and payable immediately, and upon any such declaration the same shall become and be due and payable immediately, anything in the Certificate, any Supplemental Certificate, or in any of the Bonds contained to the contrary notwithstanding, except to the extent otherwise provided in connection with a Support Facility. This provision is subject, however, to the condition that, if at any time after the principal of the Bonds, together with accrued and unpaid interest thereon shall have been so declared due and payable and before any further action has been taken (other than the making of the above declaration), the principal amount of all Bonds which have matured either according to the maturity date or dates specified therein or otherwise (except as a result of such declaration) and all arrears of interest upon all Bonds, except interest accrued but not yet due on said Bonds, shall be paid or caused to be paid, and all other Events of Default, if any, which shall have occurred shall have been remedied, cured or secured, then and in every such case the Holders of a majority in principal amount of the Senior Bonds then Outstanding and not less than 25% in principal amount of the Subordinate Bonds then Outstanding, by notice in writing delivered to the Department and the Director of Finance, may waive such default and its consequences and rescind such declaration. No such waiver or rescission or annulment shall extend to or affect any subsequent default or impair or exhaust any right or power consequent thereon.

Bondholders' Committee. Upon the occurrence of an Event of Default and at any time such Event of Default shall be continuing, the Holders of not less than 20% in principal amount of the Senior Bonds then Outstanding and not less than 20% in principal amount of the Subordinate Bonds then Outstanding may call a meeting of the Holders of Bonds for the purpose of electing a Bondholders' Committee. Such meeting shall be called and proceedings thereat shall be conducted as provided for other meetings of Bondholders pursuant to the Certificate. At such meeting the Holders of not less than a majority of the principal amount of the Senior Bonds then Outstanding and not less than a majority of the principal amount of the Subordinate Bonds then Outstanding must be present in person or by proxy in order to constitute a quorum for the transaction of business, less than a quorum, however, having power to adjourn from time to time without any notice. A quorum being present at such meeting, the Bondholders present in person or by proxy may, by the votes cast by the Holders of a majority in principal amount of the Senior Bonds and by the Holders of a majority in principal amount of the Subordinate Bonds so present in person or by proxy, elect one or more persons who may or may not be Bondholders to the

Bondholders' Committee which shall act as trustee for all Bondholders. The Bondholders present in person or by proxy at said meeting, or at any adjourned meeting thereof, shall prescribe the manner in which the successors of the persons elected to the Bondholders' Committee at such Bondholders' meeting shall be elected or appointed, and may prescribe rules and regulations governing the exercise by the Bondholders' Committee of the power conferred upon it, and may provide for the termination of the existence of the Bondholders' Committee.

Suits at Law or Equity and Mandamus. In case any one or more of the Events of Default shall happen and be continuing, then and in every such case, but subject to the provisions, limitations and conditions contained in the Certificate so far as the remedies provided in the Certificate are concerned, the Holder of any Bond at the time Outstanding shall be entitled, for the equal benefit and protection of all Holders of the Bonds similarly situated to proceed and protect and enforce the rights vested in such Holder by the Certificate by such appropriate judicial proceeding as such Holder shall deem most effectual to protect and enforce any such right, either by suit in equity or by action of law, whether for the specific performance of any covenant or agreement contained in the Certificate, or in aid of the exercise of any power granted in the Certificate, or to enforce any other legal or equitable right vested in the Holders of Bonds by the Certificate or by law.

Remedies Not Exclusive: Effect of Waiver of Default; Effect of Abandonment of Proceedings or Adverse Determination. The Holders from time to time of the Bonds shall be entitled to all the remedies and benefits of the Certificate as is and as shall be provided by law, and nothing in the Certificate shall be construed to limit the rights or remedies of any such Holders under any applicable statute that may now exist or be enacted hereafter. The remedies prescribed by the Certificate shall not be exclusive of any other remedy or remedies, and each and every such remedy shall be cumulative and shall be in addition to every other remedy given thereunder, or now or hereafter existing at law or in equity or by statute and may be exercised without exhausting and without regard to any other remedy.

No waiver of any default or breach of duty or contract by any Holder or any Bond shall extend to or affect any subsequent default or breach of duty or contract, or shall impair any rights or remedies thereon. No delay or omission of any Holder of a Bond to exercise any right or power accruing upon any default shall impair any such right or power or shall be construed to be a waiver of any such default or acquiescence therein. Every substantive right and remedy conferred upon the Holders of the Bonds may be enforced from time to time and as often as may be deemed expedient. In case any suit, action or proceeding to enforce any right or exercise any remedy shall be brought or taken and then discontinued or abandoned, or shall be determined adverse to the Holders of the Bonds, then and in every such case the State and such Holders shall be restored to their former positions and rights and remedies as if no suit, action or proceeding had been brought or taken.

Discharge of Obligations of the State Under the Certificate [Certificate Section 11.01]

The obligations of the State, including, without limiting the generality of the foregoing, of the Department, under the Certificate and the liens, pledges, charges, trusts, assignments, covenants and agreements of the State, including the Department, therein made or provided for, shall be fully discharged and satisfied as to any Bond and such Bond shall no longer be deemed to be Outstanding under the Certificate,

(A) if such Bond shall have been purchased and cancelled by the State or surrendered to the Director of Finance or other Paying Agent, transfer agent or Registrar for cancellation or be subject to cancellation by him or it, or

(B) as to any Bond not theretofore purchased and cancelled, surrendered for cancellation or subject to cancellation, when payment of the principal of and the applicable redemption premium, if any, on such Bond, plus interest on such principal (calculated, in the case of Variable Rate Bonds, at the maximum numerical rate permitted by the terms thereof) to the due date thereof (whether such due date be by reason of maturity or upon redemption or prepayment or by declaration as provided in the Certificate, or otherwise) either

(1) shall have been made or caused to be made when due and payable in accordance with the terms thereof, or

(2) shall have been provided by irrevocably depositing with the Director of Finance or other Paying Agent therefor, in trust solely for such payment, either (i) moneys sufficient to make such payment or (ii) Federal Securities maturing as to principal and interest in such amounts and at such times as will insure the availability of sufficient moneys to make such payment, or (iii) a combination of both moneys and Federal Securities, and all necessary and proper fees, compensation and expenses of any Paying Agent, transfer agent or Registrar appointed by the State pertaining to the Bond with respect to which such deposit is made shall have been paid or the payment thereof provided for to the satisfaction of such Paying Agent, transfer agent or Registrar. At such time as a Bond shall be deemed to be no longer Outstanding under the Certificate, as aforesaid, except for the purpose of any such payment from such moneys or Federal Securities, such Bond shall no longer be secured by or entitled to the benefits of the Certificate and shall cease to accrue interest from the due date thereof (whether such due date be by reason of maturity or upon redemption or prepayment or by declaration as provided therein, or otherwise).

Notwithstanding the foregoing, with respect to Bonds which by their terms may be redeemed or otherwise prepaid prior to the stated maturities thereof and which the State elects to so redeem or prepay, no deposit under clause (2) of subparagraph (B) above shall constitute such discharge and satisfaction as aforesaid until such Bonds shall have matured or shall have been irrevocably called or designated for redemption or prepayment and proper notice of such redemption or prepayment shall have been given as provided in the Certificate or irrevocable provision shall have been made for the giving of such notice; provided that nothing in the foregoing shall require or be deemed to require the State to elect to redeem or prepay such Bonds or, in the event the State shall elect to redeem or prepay such Bonds, shall require or be deemed to require the redemption or prepayment as of any particular date or dates.

Any such moneys so deposited with the Director of Finance or other Paying Agents as described above may at the direction of the Department be invested and reinvested in Federal Securities, maturing in the amounts and times as hereinbefore set forth, and all income from all such Federal Securities in the hands of the Director of Finance and other Paying Agents which is not required for the payment of the Bonds and interest and premium, if any, thereon with respect to which such moneys shall have been so deposited, shall, to the extent permitted by law, be deposited in the Highway Revenue Special Account as and when realized and collected for use and application as are other moneys deposited in such Fund.

Notwithstanding the foregoing, the payment of (i) the purchase price of and interest on Variable Rate Bonds tendered for purchase pursuant to the terms thereof and of a remarketing agreement, or similar agreement, or (ii) principal of or interest on any Variable Rate Bonds with a draw, borrowing or payment under a Support Facility shall not be deemed payment of such Variable Rate Bonds pursuant to the Certificate; provided, however, that with respect to (ii) above, a reimbursement or other payment by the State with respect to a draw, borrowing or payment under a Support Facility for the payment of principal, premium, if any, or interest on Variable Rate Bonds when due, shall be deemed to the payment of such Variable Rate Bonds for the purpose of said provision.

All moneys or Federal Securities set aside and held in trust pursuant to the foregoing provisions for the payment of Bonds (including interest and premium thereon, if any) shall be applied to and used solely for the payment of the particular Bonds (including interest and premium thereon, if any) with respect to which such moneys and Federal Securities have been so set aside in trust.

If moneys or Federal Securities have been deposited or set aside with the Director of Finance or other Paying Agent pursuant to the Certificate for the payment of Bonds and such Bonds shall be deemed to have been paid and be no longer Outstanding, but such Bonds shall not have in fact been actually paid in full, no amendment to the provisions of the Certificate relating to the defeasance of Bonds shall be made without the consent of the Holder of each Bond affected thereby and such Bonds shall be considered to be Outstanding for purposes of the Certificate.

The State may at any time surrender to the Director of Finance for cancellation by him any Bonds previously executed and delivered, which the State may have acquired in any manner whatsoever, and such Bonds upon such surrender for cancellation shall be deemed to be paid and no longer Outstanding under the Certificate.

APPENDIX B**ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES,
THE STATE HIGHWAY SYSTEM AND THE DEPARTMENT OF TRANSPORTATION**

This Appendix B contains additional information relating to Revenue sources and other factors affecting the Department's ability to raise Revenues, federal aid to Hawaii, the State Highway System and the Department of Transportation.

INFORMATION RELATING TO REVENUE SOURCES

Motor Vehicle Registration. The following table sets forth the total number of motor vehicle registrations subject to renewal in the State by type of vehicle for each of the last ten calendar years ending December 31, 2010.

Motor Vehicle Registration

<u>Calendar Year</u>	<u>Passenger Vehicles</u>	<u>Ambulances & Hearses</u>	<u>Buses</u>	<u>Trucks</u>	<u>Motorcycles & Scooters</u>	<u>Trailers</u>	<u>Total</u>
2001	775,737	58	2,847	169,223	19,286	25,412	992,563
2002	792,482	62	2,814	171,813	20,427	25,996	1,013,594
2003	830,672	47	2,588	175,517	22,019	26,780	1,057,623
2004	867,120	44	2,510	179,592	20,746	28,435	1,098,447
2005	906,799	47	2,472	185,646	24,874	29,565	1,149,403
2006	907,659	46	2,349	191,230	26,024	31,789	1,157,027
2007	911,607	47	2,260	193,650	26,978	32,698	1,167,240
2008	903,518	57	2,213	193,332	28,447	33,076	1,160,643
2009	895,770	63	2,143	190,935	28,879	32,138	1,149,928
2010	898,452	64	2,103	190,025	29,436	31,601	1,151,681

Source: *Summary of Registered Vehicles, Various Years, Department of Information Technology, City & County of Honolulu.*

Licensed Drivers. The following table sets forth the total number of drivers' licenses in force in the State for the ten calendar years ending December 31, 2010.

Drivers' Licenses in Force

<u>Year</u>	<u>Oahu</u>	<u>Hawaii</u>	<u>Maui</u>	<u>Kauai</u>	<u>Total</u>
2001	542,244	106,557	93,595	45,424	787,820
2002	560,222	110,561	97,045	46,840	814,668
2003	572,665	113,760	99,716	48,047	834,188
2004	577,507	116,486	100,916	48,967	843,876
2005	584,492	119,741	102,050	49,880	856,163
2006	590,975	122,087	103,402	50,539	867,003
2007	600,264	125,063	105,635	51,504	882,466
2008	607,747	127,456	108,259	52,479	895,941
2009	614,783	128,692	109,304	52,925	905,704
2010	618,975	129,041	110,420	52,981	911,417

Source: *State of Hawaii Driver Distribution, All Licensed Drivers, Various Years, Department of Information Technology, City & County of Honolulu.*

Fuel Consumption. The following table is a summary of the gallons of motor vehicle fuels imported into and consumed in the State, subject to the motor vehicle fuel tax for the ten fiscal years ending June 30, 2010.

**Motor Vehicle Fuel Consumption
(In Thousands of Gallons)**

<u>Fiscal Year</u>	<u>Gasoline</u>	<u>Diesel</u>	<u>Alternative Fuels</u>	<u>Total</u>
2001	411,314	210,970	3,643	625,927
2002	416,827	219,694	3,179	639,700
2003	434,595	161,132	3,160	598,887
2004	459,132	170,318	2,019	631,469
2005	455,846	249,407	5,092	710,345
2006	466,542	211,448	2,557	680,547
2007	483,274	171,918	2,939	658,131
2008	455,390	296,742	38,887*	791,019
2009	436,889	222,570**	41,861*	701,320
2010	412,809	200,725**	51,418*	664,952

* The drastic increases of alternative fuel data after fiscal year 2007 were mainly due to the filing format changes effective from September 2007 to reflect the reporting requirements from the Federal Highway Administration (FHWA). Some alternative fuel consumptions previously filed as gasoline now have to be separated and reported as alternative fuels.

** Decrease of motor fuel consumption due to State's economic downturn, higher fuel cost and lesser travels.

Source: Liquid Fuel Tax Base & Tax Collections - FY Ending June 30, 2010, Hawaii Department of Taxation.

FACTORS THAT MAY IMPACT REVENUE SOURCES

Federal and County Fuel and Weight Taxes

Fuel taxes are presently imposed by federal, State and county governments. The retail price of a gallon of gasoline in the City and County of Honolulu presently includes fuel taxes of \$0.519 (\$0.184 federal + \$0.17 state + \$0.165 county) plus the State's 4.5% general excise tax, of which taxes only \$0.17 is the State fuel license tax. The feasibility of imposing additional taxes and fees on fuel and motor vehicles is affected in part by the amount and rate of fuel and other taxes and fees imposed by federal and county governments. These other taxes and fees are not pledged to the payment of the Bonds and are not available for such payment. The following is a summary of the various fuel taxes presently imposed by the federal government and fuel and vehicle taxes presently imposed by county governments:

Federal Fuel Taxes. The Internal Revenue Code imposes federal fuel taxes at the rate of \$0.184 per gallon of gasoline and \$0.244 per gallon of diesel fuel.

State General Excise Tax. The State's 4.0% general excise tax on goods and services (4.5% in the City and County of Honolulu) extends to gasoline, diesel fuel and liquid petroleum gas. Since 1991, general excise tax collections on fuel have been paid to the State general fund, not the State Highway Fund.

County Fuel Taxes. Each county imposes a tax on gasoline, diesel oil and liquid petroleum gas for highway use. County fuel taxes are collected by the Department of Taxation together with the fuel license taxes and deposited into the respective county highway funds to be expended by each county on county highway improvements. The fuel tax rates for the County of Hawaii are \$0.088 per gallon of gasoline and diesel oil, and \$0.029 per gallon of liquid petroleum gas. The fuel tax rates for the City and County of Honolulu are \$0.165 per gallon of gasoline and diesel oil, and \$0.054 per gallon of liquid petroleum gas. The fuel tax rates for the County of

Maui are \$0.16 per gallon of gasoline and diesel oil, and \$0.043 for liquid petroleum gas. The fuel tax rates for the County of Kauai are \$0.13 per gallon of gasoline and diesel oil, and \$0.043 per gallon of liquid petroleum gas.

County Vehicle Weight Taxes. Each county imposes and collects a tax on all vehicles, including motor vehicles, based on weight. Each county collects both State and county vehicle taxes and remits the State vehicle weight tax to the State to be paid into the State Highway Fund.

The county vehicle tax rates for the City and County of Honolulu are \$0.05 per pound for passenger motor vehicles and noncommercial vehicles not exceeding 6,500 pounds, and \$0.055 per pound for commercial vehicles and all other motor vehicles, with a minimum of \$12.00 annually for all motor vehicles and \$1.00 annually for other vehicles.

The tax rates for the County of Maui are \$0.0275 per pound for passenger motor vehicles and noncommercial motor vehicles not exceeding 6,500 pounds, and \$0.04 per pound for nonpassenger commercial vehicles and all other motor vehicles, with a minimum of \$6.00 annually for all vehicles.

The tax rates for the County of Kauai are \$0.0125 per pound for passenger motor vehicles and noncommercial motor vehicles not exceeding 6,500 pounds, and \$0.025 per pound for nonpassenger vehicles and all other motor vehicles, with a minimum of \$12.00 annually for all vehicles.

The tax rates for the County of Hawaii are \$0.075 per pound for passenger motor vehicles and noncommercial motor vehicles not exceeding 6,500 pounds, and \$0.02 per pound for nonpassenger motor vehicles and commercial vehicles and motor vehicles over 6,500 pounds, with a minimum of \$6.00 annually for all vehicles.

County Vehicle Registration Fees

Each county imposes various registration fees for vehicles, including fees for certificates of registration, license plates and decals. Each county collects both State and county vehicle registration fees and remits the State vehicle registration fees and reimbursements for State-incurred expenses to the State to be paid into the State Highway Fund. The county vehicle registration fees are \$20.00 for the City and County of Honolulu, \$5.00 for the County of Hawaii, \$12.00 for the County of Kauai, and \$17.50 for the County for Maui. The fees range from \$0.50 for decals, between \$5.00 to \$10.00 for registration certificates, between \$3.50 to \$5.00 for license plates, and between \$1.00 to \$7.00 for highway beautification fees.

None of such federal or county taxes or fees, nor the State general excise tax, is pledged to the payment of the Bonds or provides a source of revenues for such payment, but such taxes and fees do affect the feasibility of imposing additional charges on the use of vehicles.

FEDERAL AID TO HAWAII

Federal Aid Reimbursements

Generally the costs of financing highways for which the federal government provides assistance is undertaken on a shared basis with the State, with the federal government providing reimbursement to the State for 90% of eligible costs, in general, when federal-aid funding is used on Interstate Highways and 80% of the costs, in general, on other highways and streets not functionally classified as local or rural minor collector roads. Federal aid reimbursements are deposited in the State Highway Fund. Such amounts are not Pledged Funds under the Certificate.

The following table sets forth federal aid reimbursements to the State for each of the last ten fiscal years ended June 30, 2011.

Federal Aid Reimbursements to the State

<u>Fiscal Year</u>	<u>Interstate</u>	<u>Other</u>	<u>Total Amount Reimbursed</u>
2002	\$12,299,728	\$126,422,988	\$138,722,716
2003	12,653,232	119,428,422	132,081,654
2004	4,089,068	78,449,020	82,538,088
2005	4,527,856	153,676,090	158,203,946
2006	8,052,420	112,460,631	120,513,051
2007	14,222,350	103,783,481	118,005,831
2008	8,410,213	183,929,315	192,339,528
2009	16,885,899	200,117,538	217,003,437
2010	10,770,994	175,714,085	186,485,079
2011 *	14,115,541	166,163,713	180,279,254

* Unaudited.

Source: Department of Transportation.

Safe Accountable, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU)

On August 10, 2005, President Bush signed the Safety, Accountable, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU) that authorized the Federal Surface transportation programs for highways, highway safety, and transit for the five-year period from 2005 to 2009. The total amount of federal funding received by the State under this program was \$859.4 million. SAFETEA-LU expired on September 30, 2009.

The amount of funds that Congress allows the states to obligate each year (obligation limitation) is less than the funds apportioned, and it varies from year to year. In fiscal years 2009, 2010, and 2011, the amount was 93.6%, 93.5%, and 92.6% of the apportionment, respectively.

Some of the federal highway funds that Hawaii receives are passed through to the counties and other agencies. The amount of federal highway funds used by the counties and other agencies varies and depends on the projects the counties and other agencies have programmed in the Statewide Transportation Improvement Program (STIP). The highway act requires that projects using federal highway and transit funds, as well as projects that are considered regionally significant, be programmed in the STIP.

The Federal-aid Highway Program requires matching funds. With some exceptions, the matching shares are 10% State and 90% Federal for projects on the Interstate System, and 20% State and 80% Federal funds for other projects. Some activities like training and educational activities and certain safety projects are eligible for 100% funding.

THE STATE HIGHWAY SYSTEM

General

In the State, three levels of government have authority to construct and maintain public highways, streets and roads. These levels of government are the State, the counties and various federal agencies. The State is served by approximately 4,276.873 linear miles of public highways, streets and roads administered by the Department and the counties. An additional 117.64 miles of public highways, streets and roads open to the public in national parks and military reservations are the responsibility of various federal agencies, including the United States National Park Service and the military services.

There are four counties in the State: the City and County of Honolulu includes the entire island of Oahu and the uninhabited windward islands, Kauai County includes the islands of Kauai and Niihau, Maui County includes the islands of Molokai, Maui, Lanai and Kahoolawe, and Hawaii County is comprised of the island of Hawaii. There are no roadways or bridges connecting one island to another.

Honolulu, on Oahu, is the State's only major metropolitan area. Approximately 70% of the population of the State lives on Oahu.

The State's highways, streets and roads are discussed below, first by the level of government responsible for administering the roadways, followed by a discussion of the federal aid system and the functional classifications. The State Highway System receives most of the federal aid highway funds made available to the State.

State Highway System

The State Highway System, which is administered by the Department, consists of 945.040 linear miles of roadways. The Department has classified the State Highway System as follows: interstate (54.900 miles), freeway expressway (33.650 miles), principal arterial (311.600 miles), minor arterial (266.540 miles), major collector (260.660 miles), minor collector (0 miles), and local (17.690 miles).

The following tables set forth the number of miles of the various categories of public highways, streets and roads, comprising the State Highway System.

State Highway System							
Functional Classification	Oahu	Hawaii	Maui	Kauai	Molokai	Lanai	Total
Interstate	54.900	0.000	0.000	0.000	0.000	0.000	54.900
Freeway Expressway	33.630	0.000	0.000	0.000	0.000	0.000	33.650
Principal Arterial	124.040	111.150	55.330	21.080	0.000	0.000	311.600
Minor Arterial	23.320	167.260	29.380	46.580	0.000	0.000	266.540
Major Collector	6.510	61.740	84.150	38.950	55.650	13.680	260.660
Minor Collector	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Local	<u>14.610</u>	<u>0.000</u>	<u>0.000</u>	<u>3.080</u>	<u>0.000</u>	<u>0.000</u>	<u>17.690</u>
Total	257.010	340.150	168.860	109.690	55.650	13.680	945.040

Source: Department of Transportation, HPMS.

The most important component of the State Highway System is the interstate system on Oahu. Interstate H-1 is a 27.160-mile freeway through the major populated areas of Honolulu, from Ewa on the western end of Oahu to Kahala on the eastern end. Interstate H-2 is an 8.330-mile freeway from the H-1 freeway at Pearl City to the U.S. Army's Schofield Barracks in Wahiawa. Interstate H-3 is a 15.320-mile freeway from the H-1 freeway at Halawa Valley in Pearl Harbor through the Koolau mountains to the U.S. Marine Corps Air Station at Kaneohe in windward Oahu. The 4.090-mile Interstate H-201, Moanalua Freeway connects to the H-1 Freeway at the Middle Street and Halawa Interchanges.

Other major State highways on the island of Oahu include the Pali Highway and Likelike Highway which connect Honolulu to the Windward Oahu communities of Kailua and Kaneohe, respectively, and Kamehameha Highway and Farrington Highway, which circle Oahu's windward and leeward coastlines. Kalaniana'ole Highway circles the eastern part of Oahu and connects eastern Honolulu to the windward coastline.

Major State highways on the island of Hawaii include the Queen Kaahumanu Highway in North Kona, the Kuakini Highway in South Kona, the Mamalahoa Highway in West Hawaii, and portions of the Hawaii Belt Road in East Hawaii.

Major State highways on the island of Kauai include Kaumualii Highway in west Kauai and Kuhio Highway in east Kauai.

Major State highways in Maui County, include on the island of Maui Honoapiilani Highway and Kahekili Highway in West Maui and Hana Highway, Haleakala Highway, Mokulele Highway and Piilani Highway in east Maui. Maunaloa Highway and Kamehameha V Highway are the major State roads on the island of Molokai.

Federal Agencies

Various federal agencies have jurisdiction over certain public highways, streets and roads open to the public in national parks and military reservations in the State, including the United States National Park Service and the military services. The United States National Park Service also builds and maintains roads within the boundaries of the national parks.

THE DEPARTMENT OF TRANSPORTATION

Management Directions. On January 5, 2007, a Letter of Agreement and Stewardship Plan between the Department and the Federal Highway Administration was approved. These documents accomplished a major goal of the respective agencies, which was to, in partnership, further improve program and project delivery in the State through the outlining of responsibilities and accountability.

The Department continues to focus its management efforts on programs that will bring about operational improvements and cost efficiencies through innovation and new technology. The Department implemented a new concept approach to working with the private sector referred to as “partnering.” All parties must agree to commit to the quality, safety, timeliness and cost efficiency of the project.

To increase efficiency for planning and maintaining highway improvements, the Department is utilizing an integrated and automated database management system. This Coordinated Data System (CDS) will compile all highway improvement data (*e.g.*, road inventory, pavement condition survey, vehicular traffic, highway improvement and maintenance expenditure) provided by the various offices within the Department. Updating and maintenance of such data will be transmitted electronically to the CDS.

To service the general public more efficiently, the Department installed electronic highway message signs at various locations on Oahu to forewarn motorists of lane closures, obstructions or accidents ahead. The Department also keeps the employees and general public informed on projects, events, public hearings and departmental news with newsletters, an internet site and provides telephone hotlines for instant information and feedback.

Oahu Metropolitan Planning Organization (“OMPO”). The Federal Surface Transportation Assistance Act of 1973 and other federal laws require states to designate and fund a metropolitan planning organization (MPO) for any urbanized area with a population greater than 500,000 to ensure that the plans and program for each metropolitan area shall provide for the development and integrated management and operation of transportation systems and facilities that will function as an intermodal transportation system for the metropolitan area. The process for developing the plan and program is required to provide for the consideration of all modes of transportation and to be continuing, comprehensive, and cooperative.

In 1975, the State Legislature established the Oahu Metropolitan Planning Organization (OMPO), an advisory organization responsible for coordinating transportation planning for Oahu. The decision making body of OMPO is its Policy Committee, which consists of six state legislators, five Honolulu City Council members, the Director of the State Department of Transportation and the Director of the City Department of Transportation Services.

OMPO is responsible for identifying Oahu’s future transportation needs and programming the federal funds for projects and programs. The federal funds are programmed based on a process which prioritizes the projects based on needs and available funding. This is achieved through the development of the following three documents:

(a) The Oahu Regional Transportation Plan (ORTP) – The 25-year long range transportation plan for Oahu.

(b) The Overall Work Program (OWP) – Annual work program that identifies all of OMPOs planning activities.

(c) The Transportation Improvement Program (TIP) – The four-year multimodal transportation improvement program for Oahu. The TIP also includes two illustrative years beyond the four approved years (six years total). It is updated every three years and is adopted directly into the Statewide Transportation Improvement Program (STIP), without change.

Statewide Transportation Improvement Program (“STIP”). On December 20, 2010, the Federal Highway Administration approved the STIP for fiscal years 2011 to 2014. Along with the four approved years of the STIP, two illustrative years were also included to show upcoming efforts. Since the initial approval of the 2011-2014 (+2) STIP, it has been revised three times; twice with major amendments, and once with minor administrative modifications. With the start of the new federal fiscal year, the state has begun making preparations for a fourth revision of the 2011-2014 (+2) STIP. We expect this revision to be federally approved by early next calendar year.

Authorized Projects. The following capital improvements projects have been authorized for implementation by the State Legislature and the Governor and comprise a part of the total highway program.

<u>Project Description</u>	<u>Phase</u>	<u>Amount Allotted Pre-FY2012</u>	<u>Estimated Allotment FY2012</u>
Leeward Bikeway, Phase I	Construction		\$1,700,000
Freeway Management System, Interstate H-1, H-2, and Moanalua Freeway, System Manager	Design		\$800,000
Freeway Management System, Interstate H-1, H-2, and Moanalua Freeway, Phase 1C, Part 1A	Construction		\$729,000
Interstate Route H-1, PM Contraflow Lane, Phase 2, Vicinity of Radford Drive to Waiawa Interchange	Construction	\$6,844,000	
Castle Hills Access Road Drainage Improvements, Phase II	Construction		\$1,100,000
Interstate Route H-1 Widening, Ola Lane Overpass to Vineyard Boulevard, Oahu	Design	\$1,000,000	
Interstate Route H-1, Eastbound Improvements, Vicinity of Ola Lane to Vicinity of Vineyard Boulevard Off Ramp	Construction		\$10,100,000
Interstate Route H-1, Pearl City Viaduct and Waimalu Viaduct Improvements	Construction	\$1,975,155	
Kamehameha Highway, Kaipapau Stream Bridge Replacement	Construction		\$3,000,000
Farrington Highway, Replacement of Makaha Bridge No. 3 and Makaha Bridge No. 3A	Construction		\$3,300,000
Interstate Route H-1, Addition and Modification of Freeway Access, Kapolei Interchange Complex (Phase 3)	Construction		\$2,500,000
Pali Highway, Highway Lighting Improvements, Hairpin Turn to Castle Junction	Construction		\$1,200,000
Slope Improvements for Erosion Control at Various Sites on Oahu, Phase 5	Construction		\$3,000,000
Interstate Route H-1, Kunia Interchange Improvements	Plans		\$780,000

<u>Project Description</u>	<u>Phase</u>	<u>Amount Allotted Pre-FY2012</u>	<u>Estimated Allotment FY2012</u>
Miscellaneous Best Management Practices	Construction		\$1,650,000
Farrington Highway Drainage Improvements, Vicinity of Orange Street	Construction		\$3,500,000
Queen Kaahumanu Highway Widening, Henry Street to Kealakehe Parkway (Phase I)	Construction	\$450,000	
Queen Kaahumanu Highway Widening, Phase II, Kealakehe Parkway to Keahole Airport Access Road	Construction	\$14,302,300	
Kuakini Highway Roadway and Drainage Improvements, Vicinity of Kamehameha III Road, Phase I	Construction	\$3,341,000	
Kuakini Highway, Roadway and Drainage Improvements, Vicinity of Kamehameha III Road, Phase II	Construction		\$3,406,000
Keaau-Pahoa Road Shoulder Lane Conversion, Keaau Bypass Road to Shower Drive	Construction		\$4,697,000
Volcano Road Intersection and Drainage Improvements, Vicinity of Kulani Road	Construction	\$600,000	\$1,388,000
Hawaii Belt Road, Bridge Repair and Paint Steel Members, Umauma Bridge	Construction		\$7,000,000
Honoapiilani Highway Realignment, Phase-IA, Future Keawe Street Extension to Lahainaluna Road	Construction	\$923,999	\$7,200,000
Honoapiilani Highway Realignment, Phase-1B-1, Lahainaluna Road to Hokiokio Place	Construction	\$3,538,653	
Honoapiilani Highway, Shoreline Protection at Launiupoko	Construction		\$2,000,000
Hana Highway Rockfall Mitigation, Vicinity of Milepost 12	Design	\$388,000	
Hana Highway Rockfall Mitigation, Vicinity of Milepost 12	Construction		\$4,382,000
Hana Highway Improvements, Phase 2, Huelo to Hana	Construction		\$2,133,000
Hana Highway Improvements, Uakea Road to Keawa Place	Construction		\$2,300,000
Waiehu Beach Road, Rehabilitation of Iao Stream Bridge	Construction		\$1,300,000
Hana Highway, Drainage Improvements, Vicinity of Hoolawa Bridge	Construction		\$1,201,000
Kamehameha V Highway, Kawela Stream Bridge Replacement	Construction	\$2,000,000	
Kamehameha V Highway, Drainage Improvements, Vicinity of Mohala Street to Vicinity of Oki Place	Construction		\$2,150,000
Kaumualii Highway Widening, Vicinity of Lihue Mill Bridge to Vicinity of Rice Street	Construction	\$4,596,200	\$5,900,000
Hawaii Belt Road Safety Improvements in the Vicinity of Papaikou Mill Road	Construction	\$600,000	

<u>Project Description</u>	<u>Phase</u>	<u>Amount Allotted Pre-FY2012</u>	<u>Estimated Allotment FY2012</u>
Kuhio Highway, Emergency Slope Repairs, Vicinity of Lumahai	Construction		\$4,250,000
Kuhio Highway, Retaining Walls at Lumahai and Wainiha, Phase 2	Design	\$500,000	
Kaumualii Highway, Intersection Improvements at Kuli Road and Lauoho Road	Design	\$320,000	
Kaumualii Highway, Intersection Improvements at Kuli Road and Lauoho Road	Land		\$824,000
Kaumualii Highway, Intersection Improvements at Kuli Road and Lauoho Road, Phase 1	Construction		\$2,148,000
Kuhio Highway Intersection Improvements at Kapule Highway	Construction	\$450,000	
Kuhio Highway, Replacement of Wainiha Bridges	Design		\$1,000,000
Kuhio Highway, Slope Stabilization, Vicinity of Hanalei Bridge	Construction	\$6,052,074	
Kuhio Highway, Intersection Improvements at the Intersections of Kauai Community Correctional Center (KCCC) and Wailua Golf Course	Design	\$376,000	\$3,100,000
Interstate Route H-1, Seismic Retrofit, Pali Highway Overpass, Ramp, and Pali Highway-Nuuanu Avenue Separation	Construction	\$422,000	
Honoapiilani Highway, Shoreline Protection for Tsunami Damage, in Ukumehame	Construction		\$6,600,000
Kamehameha Highway, Shoreline Protection, Vicinity of Kaaawa-Kaolo Point	Design		\$1,000,000
Kamehameha Highway, Rockfall Protection at Waimea Bay, MP 5.63 to MP 5.9	Design		\$750,000
Height Modernization Facilities, Statewide, Phase 1	Construction		\$3,396,000

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GENERAL INFORMATION ABOUT THE STATE OF HAWAII

The statistical information presented by this Appendix C is the most current information available to the State. Because such information becomes available at different times, the dates of such information, as presented herein, are not the same.

INTRODUCTION

General

The State was admitted into the Union on August 21, 1959, as the fiftieth state. It is an archipelago of eight major islands, seven of which are inhabited, plus 124 named islets, totaling 6,425 square miles in land area, located in the Pacific Ocean in the Northern Hemisphere, mostly below the Tropic of Cancer, about 2,400 statute miles from San Francisco. The State is slightly larger than the combined area of the States of Connecticut and Rhode Island and ranks forty-seventh of the fifty states in land area, being also larger in area than the State of Delaware. The island of Hawaii is the largest island, with 4,028 square miles in area. The other inhabited islands, in order of size, are Maui, Oahu, Kauai, Molokai, Lanai and Niihau. According to the U.S. Census, the total population of the State was 422,770 in 1940, 499,794 in 1950, 632,772 in 1960, 769,913 in 1970, 964,691 in 1980, 1,115,274 in 1990, 1,211,537 in 2000, and 1,360,301 in 2010, making the State the 40th most populous state in the Union as of 2010. The City and County of Honolulu consists of the island of Oahu (plus some minor islets) with a land area of 599.8 square miles. The capital of the State and the principal port are located on Oahu. According to the 2010 U.S. Census, about 70.1 percent of the population of the State lives on Oahu. Hawaii's population exhibits greater ethnic diversity than other states because it is descended from immigrants from the Far East as well as from Europe and the mainland United States. Based on the 2010 U.S. Census, approximately 38.6 percent of the State's population is of Asian descent and about 24.7 percent of the State's population is Caucasian. Native Hawaiians and other Pacific Islanders constitute 10.0 percent of the population. The balance consists of people of mixed races and other races, such as African Americans and American Indians.

State Government

The Constitution of the State provides for three separate branches of government: the legislative branch, the executive branch and the judicial branch. The legislative power is vested in a bicameral Legislature consisting of a Senate of twenty-five members elected for four year terms and a House of Representatives of fifty-one members elected for two year terms. The Legislature convenes annually. The executive power is vested in a Governor elected for a four year term. In the event of the absence of the Governor from the State, or his or her inability to exercise and discharge the powers and duties of his or her office, the Lieutenant Governor, also elected for a four year term, serves as the chief executive. Under the Constitution, the judicial power is vested in a Supreme Court, one intermediate appellate court, circuit courts, district courts, and such other courts as the Legislature may from time to time establish. Pursuant to statute, the Legislature has established four circuit courts, four district courts and an intermediate appellate court. The executive and administrative offices are limited to not more than twenty principal departments under the supervision of the Governor. The executive functions have in fact been grouped into eighteen departments. The heads of the departments are appointed by the Governor, with the advice and consent of the Senate, and hold office for a term to expire with the term of the Governor. The Department of Budget and Finance is one of the principal departments permitted by the Constitution of the State, with the head of said department being designated as the Director of Finance. Under the general direction of the Governor, the Department of Budget and Finance administers the State's proposed six year program and financial plan, the State budget, and financial management programs of the State.

No Voter Initiative and Referendum

The Hawaii State Constitution and Hawaii state law do not authorize either State-wide voter initiatives (that is, the electoral process by which a percentage of voters can propose legislation and compel a vote on it to enact such a measure) or State-wide referendum actions (that is, the process of referring a state legislative act or an

important public issue to the public for their final approval by public vote). The issuance of bonds is not subject to approval by public vote.

The Counties and Their Relationship to the State

There are four counties in the State: the City and County of Honolulu, the County of Maui, the County of Hawaii and the County of Kauai (and one quasi county, Kalawao). Each of the counties has a separate charter for its government, each of which provides for an elected mayor and an elected council. The mayor is the chief executive and the council is the legislative body. There are no independent or separate cities or other municipalities, school districts or townships. The State government of Hawaii has total responsibility for many functions that are performed by or shared by local governments in most other parts of the United States. For example, the State pays all costs in connection with the public school system, libraries, public welfare, and judiciary. The greatest expenditures by the State in past years have been in the areas of education and public welfare. The counties' major areas of responsibility and expenditure are in police and fire protection, waste disposal, water and sewer facilities, and secondary streets and highways.

EMPLOYEE RELATIONS; STATE EMPLOYEES' RETIREMENT SYSTEM

Employee Relations

The Constitution grants public employees in the State the right to organize for the purpose of collective bargaining. HRS Chapter 89 provides for 13 recognized bargaining units for all public employees throughout the State including State and county employees. Each bargaining unit designates an employee organization as the exclusive representative of all employees of such unit, which organization negotiates with the public employer. In the case of bargaining units for nonsupervisory blue collar positions, supervisory blue collar positions, nonsupervisory white collar positions, supervisory white collar positions, registered professional nurses, institutional health and correctional workers and professional and scientific employees, the Governor of the State shall have six votes, and the mayors of each of the counties, the Chief Justice of the State Judiciary and the Hawaii Health Systems Corporation Board shall each have one vote. In the case of bargaining units for police officers and fire fighters, the Governor shall have four votes and the mayors shall each have one vote. In the case of bargaining units for teachers and educational officers, the Governor shall have three votes, the State Board of Education shall have two votes and the state superintendent of education shall have one vote. In the case of bargaining units for University of Hawaii (UH) faculty and UH administrative professional and technical staff, the Governor shall have three votes, the UH Board of Regents shall have two votes and the UH president shall have one vote. Decisions by the employer representatives shall be on the basis of simple majority, except when a bargaining unit includes county employees from more than one county. In such case, the simple majority shall include at least one county.

By statute, if an impasse in any negotiation is declared, the parties may attempt to resolve the impasse through mediation, fact finding, and, if mutually agreeable to the parties, final and binding arbitration. Although the statute characterizes arbitration as "final and binding," it also provides that all cost items are subject to appropriations by the appropriate legislative bodies. If final and binding arbitration is not agreed upon, either party may take other lawful action to end the dispute, which, in the case of blue collar workers, public school teachers and university professors, could include an employee strike. In the case of the remaining ten bargaining units, including fire fighters and police officers, a strike is prohibited by law, and negotiation impasses are subject to mandatory final and binding arbitration, subject to appropriation of cost items, as described above. Certain employees are not party to a formal labor contract, including elected and appointed officials and certain contractual hires.

The status of negotiations for wages and health benefits for the period from July 1, 2011 – June 30, 2013 is as follows:

A six-year agreement for the period from July 2009 through June 2015 with the University of Hawaii Professional Assembly (UHPA) reached in January 2010 provides a 6.7% salary reduction beginning January 2010 through June 2011. A payroll lag is implemented beginning with the June 30, 2010 pay day. The fourth, fifth, and sixth years of the agreement provide for lump sum payments equivalent to the reductions in the first two years of the contract, and the fifth and sixth years of the agreement provide for additional 3% increases in each year. Minimum annual salaries are also established which are adjusted in

the first, third, fourth and fifth years of the contract. The overall impact of the salary minimums and across-the-board increases is an approximate 6.6% increase going forward.

A new agreement was ratified April 25, 2011 for Unit 2 (blue collar supervisors), Unit 3 (white collar workers), Unit 4 (white collar supervisors), Unit 6 (educational officers), Unit 8 (University of Hawaii administrative, professional and technical staff), and Unit 13 (professional and scientific employees). The agreements provide for a 5% wage reduction beginning July 2011 through June 2013. These agreements contain a “most favored nation” provision that entitles the respective units to receive equivalent consideration should one of the units still in negotiation receive more favorable provisions in its agreement. Following announcement of the agreement reached by members of Unit 1 and Unit 10 (see below), representatives of Units 2, 3, 4, 6, 8 and 13 invoked the “most favored nation” provision and demanded that negotiations concerning the members of these units be reopened.

Effective July 1, 2011, the Department of Education implemented its June 9, 2011 Last, Best, and Final Offer to bargaining Unit 5 (Teachers). Provisions include a 1.5% salary reduction and 9 days of directed leave without pay for 12-month employees and 7 ½ days for 10-month employees for each fiscal year for the period July 1, 2011 through June 30, 2013.

A new agreement was ratified November 23, 2011 for Unit 1 (blue collar workers) and Unit 10 (institutional health and correctional workers). The agreement requires members to take 14 days of directed leave without pay this fiscal year and 13 days of directed leave without pay next fiscal year. The agreement also requires members to increase the portion of health care premiums they pay from 40% to 50% and guarantees no layoffs through June 30, 2013.

All unsettled bargaining units are at statutory impasse, though negotiations have continued.

Unit 9 (Nurses) members rejected a tentative agreement on April 25, 2011. Unit 9 is subject to mandatory binding arbitration. An arbitration hearing date has not been set.

Unit 11 (firefighters) is subject to mandatory binding arbitration. An arbitration hearing date has not yet been set.

In addition, the following matters are presently pending:

The Hawaii State Teachers Association has filed a prohibited practice complaint with the Hawaii Labor Relations Board regarding the Department of Education’s implementation of the employer’s Last, Best, and Final Offer and is seeking interlocutory relief from wage reductions and decreases to employer contributions for Employer-Union Health Benefits contributions. Hearings continue regarding the matter.

State Employees’ Health Benefits

Act 88, SLH 2001, Relating to Public Employees Health Benefits (partially codified as HRS Chapter 87A), established the Hawaii Employer Union Health Benefits Trust Fund (“Trust Fund”). The Trust Fund provides health and other benefit plans for public employees, retirees and their dependents. The employers participating in the Trust Fund include the State and each of the counties. Public employer contributions to the Trust Fund for the health and other benefit plans of public employees and their dependents are determined under HRS Chapter 89C, or by way of applicable public sector collective bargaining agreements. Except for reimbursement of voluntary medical insurance coverage under Medicare, public employer contributions to fund the health and other benefit plans of retirees are not to exceed certain monthly contribution levels specified in HRS Chapter 87A.

Act 245, SLH 2005 (partially codified as HRS Chapter 87D), temporarily authorized employee organizations to establish voluntary employees beneficiary association (“VEBA”) trusts to provide health benefits to state and county employees in their bargaining units outside of the Trust Fund. Each VEBA trust was to provide health benefits to State and county employees who retired after establishment of the VEBA trust (“future retirees”) and is to give State and county employees who were members of applicable bargaining units and who retired before

establishment of the VEBA trust (“existing retirees”) a one-time option to transfer from the Trust Fund to the VEBA trust. The State and county employers’ monthly contributions to each VEBA trust for active employees and future retirees were to be established by collective bargaining. Monthly contributions to each VEBA trust for existing retirees were to be equal to the contributions paid on behalf of similarly situated retirees under the Trust Fund. The stated purpose of Act 245 was to allow the temporary establishment of a VEBA trust pilot program so as to enable a thorough analysis of the costs and benefits of VEBA trusts against the Trust Fund to determine what actual savings could be realized by the State through the VEBA trust mechanism. The Hawaii State Teachers Association (“HSTA”) implemented a VEBA trust (the “HSTA-VEBA trust”) for its active employees on March 1, 2006 and for retirees on January 1, 2007. Act 245 was amended by Act 294, SLH 2007 to extend the repeal date to July 1, 2009 for any VEBA implemented in March 2006. Act 5, First Special Session 2008, amended Act 245, SLH 2005, to extend the sunset date to July 1, 2010. Act 106, SLH 2010, amended Act 245, SLH 2005, to provide a final extension of the sunset date to December 31, 2010, to allow for a smoother transition from the HSTA-VEBA trust to the Trust Fund. In September 2010, two participants in the HSTA-VEBA trust and the trustees of the HSTA-VEBA trust filed a purported class action lawsuit seeking, in part, to enjoin the transition from the HSTA-VEBA trust to the Trust Fund. See *Gail Kono, et al. v. Neil Abercrombie, et al*, Civil No. 10-1-1966-09, First Circuit Court, State of Hawaii. On December 7, 2010, the First Circuit Court denied the plaintiffs’ motion for a temporary injunction to enjoin the transition of active employees and retirees from the HSTA-VEBA trust to the Trust Fund. However, the circuit court ruled that the Trust Fund was required to provide the active employees and retirees who transitioned from the HSTA-VEBA trust to the Trust Fund with the same standard of coverage benefits that they had in their HSTA-VEBA trust health benefits plans. Based on this ruling, the active employees and retirees in the HSTA-VEBA trust were transitioned to the Trust Fund, effective January 1, 2011. The State intends to appeal that part of the circuit court’s ruling that requires the Trust Fund to provide former participants in the HSTA-VEBA trust with the same standard of coverage benefits that they had in their HSTA-VEBA trust health benefits plans.

Other Post Employment Benefits

The Government Accounting Standards Board (“GASB”) has issued Statements No. 43 (“GASB 43”), Financial Reporting for Post Employment Benefit Plans Other Than Pension Plans (“OPEBs”), and No. 45 (“GASB 45”), Accounting and Financial Reporting by Employers for Post Employment Benefits Other Than Pensions. GASB 43 was implemented by the Trust Fund for fiscal year ending June 30, 2007 and GASB 45 was implemented by the employers for fiscal year ending June 30, 2008 and for the County of Kauai for fiscal year ending June 30, 2009. The Trust Fund will separately track employer contributions and has prepared Trust Fund financial statements as an Agent Multiple Employer Plan under GASB 43.

The State has received the Trust Fund July 1, 2009 Actuarial Valuation Study (the “Trust Fund Report”) of the Trust Fund’s Other Postemployment Benefits (“OPEB”) and the HSTA-VEBA July 1, 2009 Actuarial Valuation Study (the “VEBA Report,” and, together with the Trust Fund Report, the “Reports”) of the HSTA-VEBA’s OPEBs. The Reports were prepared by the State’s professional actuarial advisors, Aon Consulting Inc. The Reports quantify the Actuarial Accrued Liabilities (“AAL”) of the respective employers under GASB 45 and develop Annual Required Contributions (“ARC”) as the basis for determining the amounts that the respective employers will report under GASB 45, effective for the fiscal year ending June 30, 2010.

The Reports provide, based on stated actuarial assumptions, costs with no prefunding of the ARC. The Trust Fund Report states that the State’s AAL as of July 1, 2009 is \$11,523.3 million, and the corresponding ARC for the fiscal year ending June 30, 2011 would be \$842.3 million. The estimated Trust Fund pay as you go funding amount for such fiscal year is \$188.3 million. The VEBA Report states that the HSTA-VEBA AAL as of July 1, 2009 is \$2,484.2 million and the corresponding ARC for the fiscal year ending June 30, 2011 would be \$211.9 million. The HSTA-VEBA pay as you go funding amount for such fiscal year is \$18.3 million. The State has commenced its analysis of the alternatives available to it in the light of the GASB 43 and 45 standards and the information contained in the Reports. The State expects to continue to fund its OPEB costs on a pay as you go basis for the near term.

The Reports will be updated every two years. Reports as of July 1, 2011 are expected to be available in or about April or May of 2012.

State Employees' Retirement System

This section contains certain information relating to the Employees' Retirement System of the State of Hawaii (the "System"). The information contained in this section is primarily derived from information produced by the System, its independent accountant and its actuary. The State has not independently verified the information provided by the System, its independent accountant and its actuary, and makes no representations nor expresses any opinion as to the accuracy of such information. The comprehensive annual financial report of the System and most recent valuation report of the System may be obtained by contacting the System. The comprehensive annual financial reports of the System are also available on the State's website at <http://ehawaii.gov>, and other information about the System are available on the System's website at <http://ers.ehawaii.gov/>. Such documents and other information are not incorporated herein by reference.

The System uses a variety of assumptions to calculate the actuarial accrued liability, actuarial value of assets and other actuarial calculations and valuations of the System. No assurance can be given that any of the assumptions underlying such calculations and valuations (including, but not limited to, the current actuarial assumptions adopted by the System's Board of Trustees, the System's benefit structure or the actuarial method used by the System) will reflect the actual results experienced by the System. Variances between the assumptions and actual results may cause an increase or decrease in, among other things, the System's actuarial value of assets, actuarial accrued liability, unfunded actuarial accrued liability or funded ratio. Actuarial assessments are "forward-looking" information that reflect the judgment of the fiduciaries of the pension plans, and are based upon a variety of assumptions (including, but not limited to, the current actuarial assumptions, benefit structure or actuarial method used by the System), one or more of which may prove to be inaccurate or be changed in the future. Actuarial assessments will change with the future experience of the pension plans. See "*General Information*" and "*Actuarial Valuation*" herein for more information on the actuarial assumptions used by the System.

Much of the disclosure set forth in this section is based on the Report to the Board of Trustees on the 85th Annual Actuarial Valuation for the Year Ended June 30, 2010 (the "2010 Valuation Report"), which is the most recent valuation report of the System. The information presented in the 2010 Valuation Report was based on actuarial assumptions adopted by the System's Board of Trustees in August 2006. As described more fully under "*General Information*" below, subsequent to the issuance of the 2010 Valuation Report, new actuarial assumptions (including, among other changes, a decrease in the investment yield rate assumption) and a revised benefit structure for new members were adopted by the Board of Trustees and/or enacted through statute to better reflect the recent actual experience of the System. As a result, the actuarial information in the 2010 Valuation Report and, in turn, set forth herein do not reflect such new assumptions and revised benefit structure. While certain benefit changes may reduce the future liabilities of the System, other new assumptions (in particular, the decrease in the investment yield rate assumption) may have an adverse impact on the actuarial funded ratio and unfunded actuarial accrued liability of the System and may lead to the Legislature further increasing the statutorily established employers' annual required contributions ("ARC"). The new assumptions, funding changes and benefit structure will be reflected in the valuation report to be prepared by the System's actuary for the year ended June 30, 2011 (the "2011 Valuation Report"), which valuation report is expected to be issued in the first quarter of calendar year 2012.

On July 8, 2011, GASB released its exposure draft of proposed changes in pension accounting and financial reporting standards for state and local governments (GASB 25 and 27), which, if implemented, would impact the accounting treatment of pension plans in which state and local governments participate. Major changes may include: (1) the inclusion of unfunded pension liabilities on the government's balance sheet (such unfunded liabilities are now reported in the notes to the government's financial statements); (2) lower actuarial discount rates would be required to be used for most plans for certain purposes of the financial statements, resulting in increased liabilities and pension expenses; and (3) shorter amortization periods for unfunded liabilities would be required to be used for certain purposes of the financial statements. Following public comments on the exposure draft in 2011, new standards could be adopted in final form in 2012 and are expected to take effect in fiscal years beginning mid-2013 for most employers.

General Information

The System began operation on January 1, 1926. The System is a cost sharing, multiple employer defined benefit pension plan. The actuarial information presented herein is provided for all employers of the System in total.

The System's plan year runs from July 1 of each year through the following June 30. The System covers all regular employees of the State and each of its counties, including judges and elected officials. As it is a cost-sharing plan, the System does not allocate its liabilities among participating employers. However, the State estimates that its share of the System, based on a percentage of payroll, is approximately 75% with the remaining 25% share as the responsibility of the four counties. Although the State's employer contributions are recorded as expenses of the General Fund, 26.3% are reimbursed from various special funds of the State.

The statutory provisions of HRS Chapter 88 govern the operation of the System. Responsibility for the general administration of the System is vested in a Board of Trustees, with certain areas of administrative control being vested in the Department of Budget and Finance. The Board of Trustees consists of eight members: the Director of Finance of the State, *ex officio*; four members of the System (two general employees, one teacher, and one retiree) who are elected by the members and retirees of the System; and three citizens of the State (one of whom shall be an officer of a bank authorized to do business in the State, or a person of similar experience) who are appointed by the Governor and may not be employees of the State or any county. All contributions, benefits and eligibility requirements are established by statute, under HRS Chapter 88, and may only be amended by legislative action.

Prior to 1984, the System consisted of only a contributory plan. Legislation enacted in 1984 created a noncontributory retirement plan for certain members of the System who are also covered under Social Security. The noncontributory plan provides for reduced benefits and covers most employees hired after June 30, 1984 and employees hired before that date who elected to join the plan. Police officers, firefighters, other enforcement officials, certain elected and appointed officials and other employees not covered by Social Security are excluded from the noncontributory plan. The minimum service required for retirement eligibility is five years of credited service under the contributory plan and ten years of credited service under the noncontributory plan. Both the contributory and noncontributory plans provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (the "AFC"). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971 or the three highest paid years of service, excluding the vacation payment (whichever is higher). The AFC for members hired after that date is based on the three highest paid years of service, excluding the vacation payment.

On July 1, 2006, a new defined benefit contributory plan (the "Hybrid Plan") was established pursuant to Act 179, SLH 2004. Members in the Hybrid Plan are eligible for retirement with full benefits at age 62 with 5 years of credited service or age 55 and 30 years of credited service. Members receive a benefit multiplier of 2% for each year of credited service in the Hybrid Plan. Most new employees hired from July 1, 2006 were required to join the Hybrid Plan.

In December 2010, the System's actuary completed an Actuarial Experience Study for the five-year period ended June 30, 2010 (the "2010 Experience Study"). In fiscal year 2011, based in part on the results of the 2010 Experience Study, the Legislature acted to limit the growth of the State's pension liabilities by passing Act 163, SLH 2011. This Act, effective July 1, 2012, enacts certain changes to the funding of the System and the benefit structure for new members in all plans. Funding changes include increasing the statutorily required employer contribution rates (see "*Funding Status*" below). Benefit changes for new members include increasing the age and service requirements for retirement eligibility, reducing the retirement benefit multiplier and reducing the interest rate credited to employee contributions to 2%. The change in the interest rate credited to employee contributions to 2% is for new members in the Hybrid Plan and Contributory Plan hired on or after July 1, 2011. All other benefit changes are effective for new members hired on or after July 1, 2012. Act 163, SLH 2011, also reduced the investment yield rate assumption for fiscal year 2011 from 8% to 7.75% and gave authority to the Board of Trustees to adopt all assumptions to be used for actuarial valuations of the System, including the assumed investment yield rate for subsequent fiscal years. To better reflect the recent actual experience of the System, the Board of Trustees adopted the assumption recommendations set forth in the 2010 Experience Study, including continuing the investment yield rate assumption of 7.75%. While certain changes to the benefits and funding may reduce future liabilities and the UAAL of the System, other new assumptions (in particular, the decrease in the investment yield rate assumption) may have an adverse impact on the actuarial funded ratio and unfunded actuarial accrued liability of the System and may lead to the Legislature further increasing the statutorily established

employers' annual required contributions. The new assumptions, funding changes and benefit structure will be reflected in the 2011 Valuation Report, which is expected to be issued in the first quarter of calendar year 2012.

In fiscal year 2011, the Legislature acted to improve and protect the System's funded status by placing a moratorium on the enhancement of benefits. Act 29, SLH 2011, provides that there shall be no benefit enhancement for any group of members until the actuarial value of the System's assets is 100 percent of the System's actuarial accrued liability.

As of March 31, 2010, the contributory plan covered 7,035 active employees or 10.7% of all active members of the System, the noncontributory plan covered approximately 21,268 active employees or 32.3%, and the Hybrid Plan covered 37,587 active members or 57.0%. The Hybrid Plan membership will continue to increase in the future as most new employees hired from July 1, 2006 will be required to join this plan.

As of June 30, 2011, the System's membership comprised approximately 65,310 active employees, 6,649 inactive vested members and 39,689 pensioners and beneficiaries. The following table shows the number of active members, inactive members and retirees and beneficiaries of the System as of June 30, 2010 and 2011:

Category	June 30, 2010	June 30, 2011
Active	65,890	65,310
Inactive	6,895	6,649
Retirees and beneficiaries	38,441	39,689
Total	111,226	111,648

Funded Status

Like most public pension funds in the United States, the System was significantly impacted by the severe downturn in the investment markets during fiscal year 2009. Based on the actuarial valuation as of June 30, 2010, the System's underfunded status has increased significantly because of continued recognition of market investment losses. However, the System had a partially offsetting liability experience gain which was caused primarily by lower than expected salary increases. The unfunded actuarial accrued liability (the "UAAL") as of June 30, 2010 was \$7.138 billion. The statutory employee and employer contribution rates are intended to provide for the normal cost plus the level percentage of payroll required to amortize the UAAL over a period not in excess of 30 years. Based on the current contribution rates of 19.70% for police and fire employees and 15.00% for all other employees, the actuary has determined that the remaining amortization period is 41.3 years. Because this period is greater than 30 years (the maximum period specified by HRS Section 88-122(e)(1) and GASB 25), the financing objectives of the System are currently not being realized. Section 88-122(e)(1) of the Hawaii Revised Statutes provides that the employer contribution rates are subject to adjustment when the funding period is in excess of 30 years. See "*Funding Policy*" below for information on increases in the employer contribution rates and benefits changes to take effect to bring the funding period down to 30 years.

Funding Policy

Prior to fiscal year 2006, the System was funded on an actuarial reserve basis. Actuarial valuations were prepared annually by the consulting actuary to the Board of Trustees to determine the employer contribution requirement. In earlier years, the total actuarially determined employer contribution was reduced by some or all of the investment earnings in excess of the investment yield rate applied in actuarial valuations to determine the net employer appropriations to be made to the System. Act 327, SLH 1997, amended Section 88-107, HRS, so that, beginning with the June 30, 1997 valuation, the System retains all of its excess earnings for the purpose of reducing the unfunded actuarial accrued liability. However, Act 100, SLH 1999, reinstated the excess earnings credit for the June 30, 1997 and June 30, 1998 valuations. For those two valuations, the investment earnings in excess of a 10% actuarial return was to be applied as a reduction to the employer contributions. In accordance with the statutory funding provisions (Section 88-122, HRS, as amended by Act 147, SLH 2001), the total actuarially determined employer contribution to the pension accumulation fund was comprised of the normal cost plus the level annual payment required to amortize the unfunded actuarial accrued liability over a period of 29 years from July 1, 2000. The contribution requirement was determined in the aggregate for all employers in the System and then allocated to

individual employers based on the payroll distribution of covered employees as of the March preceding the valuation date. The actuarially determined employer contribution derived from a valuation was paid during the third fiscal year following the valuation date, *e.g.*, the contribution requirement derived from the June 30, 1998 valuation was paid into the System during the fiscal year ended June 30, 2001. The actuarial cost method used to calculate employer contributions was changed in 1997 by Act 327 from the frozen initial liability actuarial cost method to the entry age normal actuarial cost method effective with the June 30, 1995 actuarial valuation. Employer contributions were determined separately for two groups of covered employees: (1) police officers, firefighters, and corrections officers; and (2) all other employees who are members of the System.

Act 181, SLH 2004, established fixed employer contribution rates as a percentage of compensation (15.75% for their police officers and firefighters and 13.75% for other employees) effective July 1, 2005. Pursuant to Act 256, SLH 2007, employer contributions beginning July 1, 2008 increased to 19.70% for police officers and firefighters and 15.00% for all others employees. As described above, the System's actuary determined that the remaining period required to amortize the UAAL as of June 30, 2010 was 41.3 years, which is greater than the maximum of 30 years specified by HRS Section 88-122(e)(1) and GASB 25. As a result, and pursuant to the recommendations of the 2010 Experience Study, the Board of Trustees requested an increase in the statutory employer contribution rates to bring the funding period down to 30 years. In response, the Legislature enacted Act 163, SLH 2011, pursuant to which, effective July 1, 2012, employer contribution requirements will gradually increase as follows:

Employer Contribution effective starting	Police Officers and Firefighters (% of total payroll)	Other Employees (% of total payroll)
July 1, 2012	22.0	15.5
July 1, 2013	23.0	16.0
July 1, 2014	24.0	16.5
July 1, 2015	25.0	17.0

Under the contributory plan, police officers, firefighters, and corrections officers are required to contribute 12.2% of their salary to the plan and most other covered employees are required to contribute 7.8% of their salary. Under the Hybrid Plan, covered employees are generally required to contribute 6.0% of their salary to the plan, with sewer workers in specified classifications, water safety officers and emergency medical technicians required to contribute 9.75% of their salary. Effective July 1, 2012, contribution rates for newly hired employees covered under the contributory and Hybrid Plan increase by 2% pursuant to Act 163, SLH 2011, such that the corresponding contribution rates for new employees as discussed in this paragraph will be 14.2%, 9.8%, 8.0% and 11.75%, respectively. Employees covered under the noncontributory plan do not make contributions.

Actuarial Methods

The System's actuary uses the entry age normal cost method. The most recent valuation was performed for the year ended June 30, 2010.

Since the State statutes governing the System establish the current employee and employer contribution rates, the actuarial valuation determines the number of years required to amortize (or fund) the UAAL on a level percentage of payroll basis, taking into account the payroll growth assumption and the normal cost expressed as a percent of pay.

Because of this amortization procedure, any change in the unfunded actuarial accrued liability due to (i) actuarial gains and losses, (ii) changes in actuarial assumptions, or (iii) amendments, affects the funding period.

On an aggregate basis with regards to the contributory, the Hybrid, and the noncontributory plans, the total normal cost for benefits provided by the System as of June 30, 2010 was 12.60% of payroll, which was 9.59% of payroll less than the total contributions required by law (15.49% from employers plus 6.70% in the aggregate from employees). Since only 5.90% of the employers' 15.49% contribution is required to meet the normal cost (6.70% comes from the employee contribution), it is intended that the remaining 9.59% of payroll will be used to amortize

any unfunded actuarial accrued liabilities over a period of years in the future, assuming that total payroll increases by 3.50% per year.

Actuarial Valuation

The actuarial value of assets is equal to the market value, adjusted for a four-year phase-in of actual investment return in excess of or below expected investment return. The actual return is calculated net of investment and administrative expenses, and the expected investment return is equal to the assumed investment return rate multiplied by the prior year's market value of assets, adjusted for contributions, benefits paid, and refunds. The actuarial value of assets has been based on a four-year smoothed valuation that recognizes the excess or shortfall of investment income over or under the actuarial investment yield rate assumption. The actuarial asset valuation method is intended to smooth out year-to-year fluctuations in the market return. The excess or shortfall in the actual return during the year, compared to the investment yield rate assumption, is spread over this valuation and the next three valuations.

The System's actuary uses certain assumptions (including rates of salary increase, probabilities of retirement, termination, death and disability, and an investment yield rate assumption) to determine the amount that an employer must contribute in a given year to provide sufficient funds to the System to pay benefits when due. Prior to fiscal year 2012, HRS Section 88-122(b) provided for the Board of Trustees to adopt the assumptions to be used by the System except the investment yield rate, which was set by the Legislature. Act 163, SLH 2011, set the investment yield rate at 7.75% for fiscal year 2011 but also amended HRS Section 88-122(b) to allow the Board of Trustees to establish, for subsequent fiscal years, all assumptions to be used by the System, including the investment yield rate assumption. The Board of Trustees periodically evaluates and revises the assumptions used by the System for actuarial valuations, including by commissioning experience studies to evaluate the actuarial assumptions to be used by the System. The current assumptions, including the investment yield rate of 7.75%, were adopted by the System's Board of Trustees based on the recommendations of the System's actuary in the most recent experience study, the 2010 Experience Study. The new assumptions, funding changes and benefit structure will be reflected in the 2011 Valuation Report, which is expected to be issued in the first quarter of calendar year 2012.

The following table sets forth the schedule of funding progress of the System for the ten most recent actuarial valuation dates.

SCHEDULE OF FUNDING PROGRESS **(Dollar amounts in millions)**

June 30,	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (b)-(a)	Funded Ratio (a)/(b)	Payroll (c)	UAAL as a Percentage of Payroll ((b)-(a))/(c)
2001	\$ 9,516.0	\$ 10,506.9	\$ 991.0	90.6%	\$ 2,444.2	40.5%
2002	9,415.2	11,210.2	1,795.1	84.0%	2,671.7	67.2%
2003	9,074.0	11,952.1	2,878.1	75.9%	2,826.7	101.8%
2004	8,791.1	12,271.3	3,474.2	71.7%	2,865.1	121.3%
2005	8,914.8	12,986.0	4,071.1	68.6%	3,041.1	133.9%
2006*	9,529.4	14,661.4	5,132.0	65.0%	3,238.3	158.5%
2007	10,589.8	15,696.5	5,106.8	67.5%	3,507.0	145.6%
2008	11,381.0	16,549.1	5,168.1	68.8%	3,782.1	136.6%
2009	11,400.1	17,636.4	6,236.3	64.6%	4,030.1	154.7%
2010	11,345.6	18,483.7	7,138.1	61.4%	3,895.7	183.2%

Source: The 2010 Valuation Report.

* Assumption changes and new Hybrid Plan effective June 30, 2006.

The total assets of the System on a market value basis amounted to approximately \$8.8 billion as of June 30, 2009, \$9.8 billion as of June 30, 2010 and \$11.6 billion as of June 30, 2011. Actuarial certification of assets as of June 30, 2009 was \$11.4 billion (See “— *Summary of Actuarial Certification Statement*” below). The June 30, 2010 actuarial certification of assets was \$11.3 billion, and its unfunded actuarial accrued liability was \$7.1 billion. Since the System is a cost sharing, multiple employer public retirement system, the unfunded actuarial accrued liability is not allocated to the State and the counties. The following table shows the normal cost as a percentage of payroll, employee contribution rate and effective employer normal cost rate for the two groups of covered employees for fiscal year 2009 and 2010:

NORMAL COST

	June 30,					
	2009			2010		
	Police and Firefighters	Other Employees	All Employees	Police and Firefighters	Other Employees	All Employees
Normal cost as % of payroll	18.79%	11.83%	12.55%	18.80%	11.84%	12.60%
Employee contribution rate	12.20%	6.05%	6.67%	12.20%	6.05%	6.70%
Effective employer normal cost rate	6.59%	5.78%	5.88%	6.60%	5.79%	5.90%

Source: The 2010 Valuation Report.

The following table shows a comparison of the actuarial value of assets to the market values, the ratio of the AVA to market value and the funded ratio based on AVA compared to funded ratio based on market value of assets, for the last two valuation dates:

	June 30, 2009	June 30, 2010
AVA	\$11,400.1 million	\$11,345.6 million
Market Value of Assets	\$8,818.0 million	\$9,821.6 million
Market Value as Percentage of AVA	77.4%	86.6%
Funded Ratio (AVA)	64.6%	61.4%
Funded Ratio (Market Value)	50.0%	53.1%

Source: The 2010 Valuation Report.

The following table shows the annual required contributions, actual contributions and the percentage of actuarially required contribution that has been funded as of the last 10 valuation dates. Employer contribution rates are set by the statute (see above) and, accordingly, may be greater or less than the ARC:

SCHEDULE OF EMPLOYER CONTRIBUTIONS
(Dollar amounts in thousands)

June 30,	Annual Required Contribution	Actual Contribution	Percentage Contributed
2001	\$ 164,397	\$ 8,132	4.9%
2002	167,459	167,459	100.0%
2003	190,586	190,586	100.0%
2004	235,686	235,686	100.0%
2005	328,717	328,717	100.0%
2006*	423,446	423,446	100.0%
2007	476,754	454,494	95.3%
2008	510,727	488,770	95.7%
2009	526,538	578,635	109.9%
2010	536,237	547,613	102.1%

Source: The 2010 Valuation Report.

* Effective July 1, 2005 the required contributions are based on contribution rates and not specific dollar amounts.

Asset Allocation

The following table shows the target and actual asset allocation of the System as of June 30, 2011:

ASSET ALLOCATION
(as of June 30, 2011)

Asset Type	Actual Allocation		Target Allocation		Allocation Difference
	Amount (\$mm)	Percentage	Amount (\$mm)	Percentage	
Domestic Equity	\$ 5,530.0	47.8%	\$ 4,050.0	35.0%	12.8%
Non-US Equity	1,990.0	17.2%	2,430.0	21.0%	-3.8%
Fixed Income	2,710.0	23.4%	2,780.0	24.0%	-0.6%
Real Estate	810.0	7.0%	810.0	7.0%	0.0%
Private Equity	380.0	3.3%	580.0	5.0%	-1.7%
Real Return	150.0	1.3%	580.0	5.0%	-3.7%
Other	0.0	0.0%	350.0	3.0%	-3.0%
Total	\$11,600.0	100.0%	\$11,600.0	100.0%	

Source: Valuations provided by Northern Trust – 2011; values unaudited.

Employer Contribution Rate

The schedule which follows shows the total actuarially determined employer contribution rate for all employees based on the last six annual actuarial valuations.

Actuarial Valuation as of June 30	Total Calculated Employer Contribution Rate for All Employees (% of total payroll)*	Funding Period (Years)
2004	13.95	22.6
2005	13.95	25.7
2006	13.95	35.2
2007	13.95	25.5
2008	15.46	22.6
2009	15.47	28.2
2010	15.49	41.3

* Reflects Act 181, SLH 2004, which amended HRS Sections 88-105,88-122,88-123, 88-124, 88-125 & 88-126.

In fiscal year 2005, the funding period increased due to recognition of large actuarial losses. In fiscal year 2006, the funding period increased due to a large increase in the liabilities associated with the adoption of new actuarial assumptions. The funding period decreases in 2007 and 2008 reflect an increase in employer contribution rates that became effective July 1, 2008 pursuant to Act 256, SLH 2007, and the net asset gain from investments that offsets actuarial losses resulting from higher than expected salary increases. The increases in fiscal years 2009 and 2010 were from the recognition of the actuarial asset loss from the significant decline in the financial markets during fiscal year 2009. Act 163, SLH 2011, was enacted to raise the employer contribution rates over the next several years to bring the funding period in line with the 30-year statutory requirement.

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Summary of Actuarial Certification Statement

The summary of the actuarial certification of the Employees' Retirement System as of June 30, 2009 and 2010 is set forth below:

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF HAWAII
Summary of Actuarial Certification as of June 30, 2009 and 2010
(Includes all counties)

ASSETS	2009	2010
Total current assets	\$11,400,116,874	\$11,345,618,006
Present value of future employee contributions	1,454,290,782	1,435,479,895
Present value of future employer normal cost contributions	1,658,595,716	1,601,394,963
Unfunded actuarial accrued liability	6,236,315,442	7,138,050,585
Present value of future employer Early Incentive Retirement Program contribution	N/A	N/A
TOTAL ASSETS	<u>\$20,749,318,814</u>	<u>\$21,520,543,449</u>
LIABILITIES		
Present value of benefits to current pensioners and beneficiaries	8,584,029,950	9,259,425,898
Present value of future benefits to active employees and inactive members	<u>12,165,288,864</u>	<u>12,261,117,551</u>
TOTAL LIABILITIES	<u>\$20,749,318,814</u>	<u>\$21,520,543,449</u>

Source: Gabriel, Roeder, Smith & Company.

As of June 30, 2010, the unfunded actuarial accrued liability (under the entry age normal actuarial cost method) of the System amounted to approximately \$7.138 billion. The System's funded ratios – assets divided by the actuarial accrued liability - decreased during fiscal year 2010 as shown below:

FUNDED RATIOS	
<u>June 30, 2009</u>	<u>June 30, 2010</u>
64.6%	61.4%

GENERAL ECONOMIC INFORMATION

General

The following material pertaining to economic factors in the State under the captions "State of the Economy" through and including "Table 10" has been excerpted from the Hawaii State Department of Business, Economic Development and Tourism ("DBEDT") Fourth Quarter 2011 Quarterly Statistical and Economic Report ("QSER") or from other materials prepared by DBEDT, some of which may be found at <http://www.hawaii.gov/dbedt/>. Unless otherwise stated, the following information is historical, estimated figures are used only when the definitive figures are unavailable. Unless otherwise specifically stated, all references to years and quarters in the following information are for calendar years and calendar quarters, respectively. The text refers to certain enumerated tables found under "GENERAL ECONOMIC INFORMATION." Following descriptions of the various components of the State's economy and DBEDT's outlook for the economy below under "State of the Economy", there is a brief description in "Outlook for the Economy" below of the impact of these components on the State's fiscal position.

DBEDT's latest forecast for the State's nominal Gross Domestic Product ("GDP") (the value of all goods and services produced within the State, formerly called the Gross State Product or "GSP") growth in 2011 is 3.3 percent. In real terms (adjusting for inflation), DBEDT estimates that the 2011 State's GDP growth to be 1.4 percent over that of 2010.

State of the Economy

Most of the economic indicators were positive in the third quarter of 2011. Visitor expenditures, civilian wage and salary jobs, and State general fund tax revenues all increased; however, value of private building permits decreased in the quarter as compared to the same quarter last year.

The State general fund tax revenues increased in the third quarter of 2011 compared to the same quarter of 2010. All major components of the State general fund tax revenues increased in the quarter compared to the third quarter of 2010. In the first three quarters of 2011, State general fund tax revenues were up \$311.5 million or 9.7 percent over the same period of 2010. As an indicator of current economic activity, state general excise tax revenue increased 7.1 percent in the third quarter of 2011 compared to the same quarter in 2010.

The labor market conditions show that the economy continues to improve. Hawaii's unemployment rate remains among the lowest in the nation. During the first nine months of 2011, the not-seasonally adjusted unemployment rate averaged 6.3% in Hawaii, while the unemployment rate was 9.2% in the U.S. during the same time period. After ten consecutive quarterly decreases in jobs from the third quarter of 2008 to the third quarter of 2010, Hawaii's jobs increased for the fourth time. In the third quarter of 2011 Hawaii's civilian wage and salary jobs averaged 595,350 jobs, an increase of 8,600 jobs or 1.5 percent from the same quarter of 2010.

Job increase in the third quarter of 2011 was completely due to job increases in the private sector. In this quarter, the private sector added about 9,450 jobs compared to the third quarter of 2010. During the third quarter of 2011, the three levels of government together lost 1,050 jobs compared to the same quarter of 2010. The Federal government, the State government, and the Local government lost 250, 550, and 250 jobs, respectively, in the quarter.

The most recent data from the U.S. Bureau of Economic Analysis (BEA) shows that Hawaii's total nominal personal income in the second quarter of 2011 increased \$2,730 million or 4.8 percent from the same quarter of 2010. This increase includes inflation so that the growth of real personal income was smaller. The increase in nominal personal income during the second quarter of 2011 was due to increases in all major components of personal income. In dollar terms, the largest increase occurred in wage and salary disbursements, followed by dividends, interest, and rent, personal current transfer receipts, supplements to wage and salaries, which include retirement and unemployment insurance benefits, and proprietors' income. In the first half of 2011, total annualized personal income increased 4.8 percent from the same period of 2010.

According to the most recent data available, consumer prices in Honolulu increased 3.5 percent in the first half of 2011 compared with the same period of 2010, as measured by the Honolulu Consumer Price Index for Urban Consumers (CPI-U). By contrast, the U.S. CPI-U increased 2.8 percent in the first half of 2011. In 2010, the Honolulu CPI-U increased 2.1 percent from the previous year.

The higher Honolulu CPI-U in the first half of 2011 was primarily due to relatively large increases in the price index of Other Goods and Services (7.0 percent); followed by the index for Transportation (6.8 percent), Recreation (3.7 percent), and Education and Communication (3.6 percent). The prices for Housing and Food & Beverages increased 2.9 percent and 2.6 percent, respectively, while the price for Medical Care increased only 0.2 percent compared to the first half of 2010.

Visitor spending in Hawaii continued to grow in the third quarter of 2011 despite the decline in arrivals. Visitor spending increased 8.3 percent in the third quarter of 2011 compared to the same quarter of 2010. In the first three quarters of 2011, total visitor spending increased 14.7 percent compared to the same period last year. The increase in visitor spending was mainly due to the increase in daily spending. Daily visitor spending during the first 9 months of 2011 averaged \$179.8 per person, 10.1 percent higher than the \$163.4 daily spending during the same time period a year ago.

In construction, both the value of private building permits and government contracts awarded decreased. In the third quarter of 2011 the permit value for private construction decreased \$14.7 million, while government contracts awarded decreased \$228.1 million from the same quarter of 2010. However, construction jobs increased in

the third quarter of 2011 compared with the same quarter of 2010. During the first nine months of 2011, the total value of private building authorizations decreased \$188.1 million or 12.2%. In addition, the government contracts awarded decreased \$526.4 million or 66.7%; and the State Capital Improvement Project expenditures decreased \$116.5 million or 13.5% in the first three quarters of 2011 compared to the same period last year. According to the most recent data available, current construction put-in-place based on excise tax data increased \$141.7 million or 10.9 percent in the second quarter of 2011 compared with the same quarter last year.

Outlook for the Economy

Based on the most recent development in the national and global economy, the performance of Hawaii's tourism industry, the labor market conditions in the state, and growth of personal income and tax revenues, Hawaii's economy is expected to continue positive growth for the rest of 2011 and into 2012. Overall, the current DBEDT forecast is more optimistic compared with the previous forecast.

Hawaii's economy depends significantly on conditions in the U.S. economy and key international economies, especially Japan. According to the November 2011 Blue Chip Economic Consensus Forecasts, U.S. real GDP is expected to increase by 1.8 percent in 2011 as a whole, same as the growth rate projected in the August 2011 forecast. However, for 2012 the consensus forecast expects an overall 2.1 percent growth in U.S. real GDP, lower than the 2.5 percent growth rate projected in the August 2011 forecast.

Forecasts for Japan were unchanged in 2011 but revised downward for 2012 in the November 2011 Blue Chip Economic Consensus Forecasts. Real GDP growth for Japan is now expected to decrease 0.6 percent in 2011, same as the decrease projected in the August 2011 forecast. However, for 2012, the consensus forecast now expects an overall 2.2 percent growth in Japanese real GDP, lower than the 3.1 percent growth projected in the August 2011 forecast.

For the local economy, DBEDT expects that most of the economic indicators, especially personal income, will grow at faster rates compared with previously forecasted.

Overall, Hawaii's economy measured by real GDP is projected to show a 1.4 percent increase in 2011, up 0.1 percentage point from the 1.3 percent growth forecast last quarter. That growth is currently expected to increase to 1.7 percent in 2012, slightly lower than the previous forecast.

Visitor arrivals are expected to increase 2.5 percent in 2011, 0.5 of a percentage point lower than the previous forecast of 3.0 percent. The forecast for visitor days in 2011 is now expected to increase 4.0 percent, 0.4 percentage point lower than the previous forecast. The forecast for visitor expenditure in 2011; however, is revised upward to 13.1 percent, from 12.0 percent growth projected in the previous forecast. For 2012, the growth rates of visitor arrivals, visitor days, and visitor expenditures are now expected to be 3.4 percent, 3.0 percent, and 5.6 percent, respectively.

The projection for wage and salary jobs in 2011 changed from a 1.5 percent growth in the previous forecast to a 1.3 percent growth in the current forecast. In 2012, jobs are now projected to increase 1.6 percent – 0.2 percentage point lower than the previous forecast.

The Honolulu Consumer Price Index (CPI), which increased 3.5 percent in the first half of 2011, is expected to increase 3.3 percent in 2011, 0.3 percentage point higher than the previous forecast. In 2012, the CPI is projected to increase 2.8 percent.

Personal income in current dollars is expected to grow 4.6 percent in 2011, 0.8 percentage point higher than the growth in the previous forecast. Due to higher projected inflation, the real personal income is currently projected to grow 1.3 percent in 2011, 0.5 percentage point above previous forecast. In 2012, current-dollar personal income and real personal income are expected to increase 4.0 percent and 1.2 percent, respectively.

Beyond 2012 the economy will be on the expansion path with job growth of 1.8 percent in 2013 and 1.5 percent in 2014. Visitor arrivals are expected to increase 2.0 percent in 2013 and 2.2 percent in 2014. Visitor

expenditures are expected to increase 4.5 percent in 2013 and 4.4 percent in 2014. Real personal income is projected to increase 2.1 percent in 2013 and 2.5 percent in 2014. Hawaii's real GDP growth is expected to reach 2.0 percent in 2013 and 2.2 percent in 2014.

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INFORMATION ON EMPLOYMENT, WAGES AND SALARIES, TAX REVENUES AND TAX BASE

Table 1
SELECTED ECONOMIC ACTIVITIES: STATE

SERIES	3rd QUARTER			YEAR-TO-DATE		
	2010	2011	% CHANGE YEAR AGO	2010	2011	% CHANGE YEAR AGO
Civilian labor force, NSA (persons) 1/	629,550	633,750	0.7	629,550	633,900	0.7
Civilian employed, NSA	587,050	592,650	1.0	587,100	594,050	1.2
Civilian unemployed, NSA	42,500	41,100	-3.3	42,500	39,850	-6.2
Unemployment rate, NSA (%) 1/ 2/	6.7	6.5	-3.0	6.7	6.3	-6.0
Total wage and salary jobs, NSA	586,750	595,350	1.5	590,350	598,300	1.3
Total non-agric. wage & salary jobs	580,500	588,850	1.4	584,100	591,800	1.3
Nat. Resources, Mining, Constr.	28,550	28,950	1.4	28,700	28,450	-0.9
Manufacturing	12,700	12,800	0.8	12,900	12,600	-2.3
Wholesale Trade	17,650	16,850	-4.5	17,600	17,000	-3.4
Retail Trade	65,450	66,450	1.5	65,400	65,850	0.7
Transp., Warehousing, Util.	26,350	25,150	-4.6	26,250	25,600	-2.5
Information	9,850	10,800	9.6	9,800	11,000	12.2
Financial Activities	26,750	26,950	0.7	26,850	26,500	-1.3
Professional & Business Services	71,450	74,550	4.3	70,950	74,250	4.7
Educational Services	14,350	16,900	17.8	14,550	16,750	15.1
Health Care & Social Assistance	60,850	61,850	1.6	60,750	61,650	1.5
Arts, Entertainment & Recreation	10,350	10,100	-2.4	10,300	10,050	-2.4
Accommodation	34,450	35,350	2.6	34,300	35,300	2.9
Food Services & Drinking Places	55,450	56,800	2.4	55,150	56,700	2.8
Other Services	26,350	26,500	0.6	26,350	26,450	0.4
Government	119,950	118,850	-0.9	124,300	123,700	-0.5
Federal	34,850	34,600	-0.7	34,800	34,500	-0.9
State	66,000	65,450	-0.8	70,750	70,600	-0.2
Local	19,100	18,850	-1.3	18,700	18,600	-0.5
Agriculture wage and salary jobs	6,250	6,450	3.2	6,200	6,500	4.8
State general fund revenues (\$1,000)	908,912	1,201,216	32.2	3,219,395	3,528,669	9.6
General excise and use tax revenues	611,575	655,038	7.1	1,801,118	1,960,446	8.8
Income-individual	165,284	395,414	139.2	995,532	1,097,695	10.3
Declaration estimated taxes	25,123	43,899	74.7	213,598	283,458	32.7
Payment with returns	14,268	9,367	-34.3	102,792	107,924	5.0
Withholding tax on wages	341,635	359,258	5.2	1,038,457	1,084,479	4.4
Refunds ('-' indicates relative to State)	-215,741	-17,110	92.1	-359,314	-378,166	-5.2
Transient accommodations tax	69,617	79,292	13.9	184,859	235,435	27.4
Honolulu County Surcharge 3/	46,335	-	-100.0	131,786	113,595	-13.8
Private Building Permits (\$1,000) 4/	537,311	438,364	-18.4	992,643	819,238	-17.5
Residential	184,903	178,416	-3.5	420,279	325,166	-22.6
Commercial & industrial	123,515	47,200	-61.8	176,621	95,255	-46.1
Additions & alterations	228,893	212,748	-7.1	395,743	398,817	0.8
Visitor Days - by air	17,493,772	17,426,049	-0.4	49,070,156	51,105,867	4.1
Domestic visitor days - by air	13,595,501	13,163,251	-3.2	37,717,180	38,944,130	3.3
International visitor days - by air	3,898,271	4,262,798	9.4	11,352,976	12,161,737	7.1
Visitor arrivals by air - by air	1,887,418	1,870,895	-0.9	5,240,578	5,374,850	2.6
Domestic flight visitors - by air	1,381,785	1,335,712	-3.3	3,779,891	3,874,566	2.5
International flight visitors - by air	505,633	535,183	5.8	1,460,687	1,500,284	2.7
Hotel occupancy rates (%) 2/ 5/	75.3	75.9	0.6	71.2	73.8	2.6
Visitor expend. - arrivals by air (\$Mil.)	2,965	3,211	8.3	8,058	9,240	14.7

1/ Labor force and jobs are Hawaii DLIR monthly and annual data. Quarterly averages computed by the Hawaii DBEDT.

2/ Change represents absolute change in rates rather than percentage change in rates.

3/ 0.5% added to the general excise tax to pay for O'ahu's mass transit system and took effect January 1, 2007.

4/ 2nd quarter of 2011, year-to-date through June 2011.

5/ July and August for 3rd quarter, first 8 months for year-to-date.

Includes taxpayers who have business activities on Oahu but whose businesses are located outside Oahu.

Source: Hawaii State Department of Business, Economic Development, & Tourism <<http://www.hawaii.gov/dbedt/inf>>.

Hawaii State Department of Labor & Industrial Relations <<http://www.hiwi.org/cgi/dataanalysis/?PAGEID=94>>.

Hawaii State Department of Taxation <http://www.hawaii.gov/tax/a5_3txcolrpt.htm> and Hospitality Advisors, LLC.

Key Economic Indicators

Table 2

ACTUAL AND FORECAST KEY ECONOMIC INDICATORS FOR HAWAII: 2009 TO 2014

Economic Indicators	2009	2010	2011	2012	2013	2014
	(Actual)	(Actual)	(Forecast)	(Forecast)	(Forecast)	(Forecast)
Total population (thousands)	1,347	1,364	1,377	1,391	1,405	1,419
Visitor arrivals (thousands) 1/	6,517	7,084	7,262	7,509	7,660	7,831
Visitor days (thousands) 1/	60,837	66,112	68,768	70,842	72,337	73,962
Visitor expenditures (million dollars) 1/	9,993	11,167	12,625	13,338	13,937	14,544
Honolulu CPI-U (1982-84=100)	230.0	234.9	242.6	249.4	255.6	262.0
Personal income (million dollars)	54,786	56,811	59,424	61,801	64,644	67,876
Real personal income (millions of 2000\$) 2/	41,986	42,644	43,180	43,699	44,616	45,732
Total wage & salary jobs (thousands)	597.7	593.2	600.9	610.5	621.5	630.8
Gross domestic product (million dollars)	65,428	66,760	68,970	71,384	74,122	77,192
Real gross domestic product (millions of 2005\$)	58,602	59,329	60,150	61,155	62,378	63,750
Gross domestic product deflator (2005=100)	111.6	112.5	114.7	116.7	118.8	121.1
Annual Percentage Change						
Total population	1.1	1.3	1.0	1.0	1.0	1.0
Visitor arrivals 1/	-4.5	8.7	2.5	3.4	2.0	2.2
Visitor days 1/	-4.7	8.7	4.0	3.0	2.1	2.2
Visitor expenditures 1/	-12.3	11.7	13.1	5.6	4.5	4.4
Honolulu CPI-U	0.5	2.1	3.3	2.8	2.5	2.5
Personal income	-0.9	3.7	4.6	4.0	4.6	5.0
Real personal income 2/	-1.4	1.6	1.3	1.2	2.1	2.5
Total wage & salary jobs	-4.4	-0.8	1.3	1.6	1.8	1.5
Gross domestic product	-1.0	2.0	3.3	3.5	3.8	4.1
Real gross domestic product	-2.6	1.2	1.4	1.7	2.0	2.2
Gross domestic product deflator	1.6	0.8	1.9	1.8	1.8	1.9

1/ Visitors who came to Hawaii by air or by cruise ship.

2/ DBEDT calculated using BEA estimate of nominal personal income deflated by U.S. Bureau of Labor Statistics Honolulu CPI-U.

Source: Hawaii State Department of Business, Economic Development & Tourism, November 10, 2011.

Labor Force and Jobs

Hawaii's labor market conditions continued to improve in the third quarter of 2011 compared to the same quarter in 2010. While the civilian labor force increased in the quarter, civilian employment increased more and civilian unemployment decreased in the quarter. As a result, Hawaii's unemployment rate decreased to 6.5 percent in the quarter. In the first three quarters of 2011, Hawaii's unemployment rate averaged 6.3 percent, 0.4 of a percentage point below the average unemployment rate during the same period last year. For the fourth consecutive quarter, civilian wage and salary jobs increased.

In the third quarter of 2011, the civilian labor force averaged 633,750 people, an increase of 4,200 people or 0.7 percent from the same quarter of 2010. In the first three quarters of 2011, civilian labor force also increased 0.7 percent from the same period last year.

Civilian employment totaled 592,650 people in the third quarter of 2011, an increase of 5,600 people or 1.0 percent compared to the same quarter of 2010. This is the fourth consecutive quarterly increase. In the first three quarters of 2011, average civilian employment increased 1.2 percent from the same period last year.

In the third quarter of 2011, the number of civilian unemployed averaged 41,100 people, decreased 1,400 people or 3.3 percent from the same quarter of 2010. In the first three quarters of 2011, the number of unemployed decreased 6.0 percent from the same period last year.

The unemployment rate (not seasonally adjusted) decreased from 6.7 percent in the third quarter of 2010 to 6.5 percent in the third quarter of 2011. In the first three quarters of 2011, unemployment rate averaged 6.3 percent.

In the third quarter of 2011, Hawaii's civilian wage and salary jobs averaged 595,350 jobs, an increase of 8,600 jobs or 1.5 percent from the same quarter of 2010. This is the fourth quarterly increase in wage and salary jobs after ten consecutive quarterly decreases in jobs since the second quarter of 2008. In the first three quarters of 2011, average wage and salary jobs increased 1.3 percent or 7,950 jobs from the same period last year.

Job increase in the third quarter of 2011 was completely due to job increases in the private sector. In this quarter, the private sector added about 9,450 jobs compared to the third quarter of 2010. Professional and Business Services experienced the largest job gains, added 3,100 jobs; followed by Educational Services (added 2,550 jobs), Food Services and Drinking Places (added 1,350 jobs), Health Care and Social Assistance (added 1,000 jobs), Retail Trade (added 1,000 jobs), and Information (added 950 jobs). Private sector job losses were largest in the Transportation, Warehousing, and Utilities sector (lost 1,200 jobs); followed by the Wholesale Trade sector (lost 800 jobs).

During the third quarter of 2011, the three levels of government together lost 1,100 jobs compared to the same quarter of 2010. The Federal government, the State government, and local government entities lost 250, 550, and 250 jobs, respectively, in the quarter.

Table 3

CIVILIAN LABOR FORCE AND EMPLOYMENT
(Number of persons)

Year	Civilian Labor Force	% Change Civilian Labor Force	Civilian Employment	% Change Civilian Employment	Civilian Unemployment Rate
1996	596,750	1.2	561,700	0.8	5.9
1997	601,650	0.8	566,750	0.9	5.8
1998	604,300	0.4	570,150	0.6	5.7
1999	606,650	0.4	576,300	1.1	5.0
2000	609,000	0.4	584,850	1.5	4.0
2001	615,250	1.0	589,200	0.7	4.2
2002	608,950	-1.0	584,350	-0.8	4.0
2003	616,300	1.2	592,450	1.4	3.9
2004	618,150	0.3	598,200	1.0	3.2
2005	627,100	1.4	609,850	1.9	2.8
2006	633,500	1.0	617,800	1.3	2.5
2007	634,800	0.2	617,900	0.0	2.7
2008	639,650	0.8	613,800	-0.7	4.0
2009	631,800	-1.2	588,650	-4.1	6.8
2010	629,050	-0.4	587,400	-0.2	6.6
2011*	633,900	0.8	594,050	1.1	6.3

* First three quarters.

Source: Hawaii State Department of Labor and Industrial Relations.

Income and Prices

Hawaii's total personal income increased during the second quarter of 2011 over the same quarter of 2010, all major components of personal income increased in the quarter. In dollar terms, the largest increases occurred in wage and salary disbursements, followed by dividends, interest, and rent, personal current transfer receipts, supplements to wage and salaries, which include retirement and unemployment insurance benefits, and proprietors' income.

In the second quarter of 2011, total nominal annualized personal income (i.e., not adjusted for inflation) increased \$2,730 million or 4.8 percent from the second quarter of 2010. In the first half of 2011, total annualized personal income was \$58,949 million, increased 4.8 percent from the same period of 2010.

In the second quarter of 2011, wage and salary disbursements increased \$789 million or 2.9 percent from the second quarter of 2010. This was the fourth quarter-over-quarter increase since the third quarter of 2010. In the first half of 2011, wage and salary disbursements increased 2.8 percent from the same period last year.

Supplements to wages and salaries (consisting of employer payments to retirement plans, private group health insurance plans, private workers compensation plans, and other such benefits) increased \$375 million or 4.2 percent in the second quarter of 2011 from the same quarter of 2010. In the first half of 2011, supplements to wages and salaries increased 4.5 percent from the same period last year.

Proprietors' income increased \$118 million or 3.3 percent in the second quarter of 2011 over that of 2010. In the first half of 2011, proprietors' income was up 4.6 percent from the same period last year.

Dividends, interest, and rent increased \$624 million or 5.8 percent in the second quarter of 2011 from the same quarter of 2010. In the first half of 2011, income in this category was up 5.2 percent from the same period last year.

The annualized personal current transfer receipts grew by \$596 million or 6.7 percent in the second quarter of 2011 from the same quarter of 2010. In the first half of 2011, personal current transfer receipts increased 6.7 percent from the same period last year.

Contributions to government social insurance, which is subtracted from total personal income, decreased \$227 million or 5.1 percent in the second quarter of 2011 compared to the second quarter of 2010. In the first half of 2011, contributions to government social insurance decreased 4.6 percent from the same period of 2010.

In the second quarter of 2011, total non-farm private sector annualized earnings increased \$873 million or 3.3 percent from the second quarter of 2010. In dollar terms, the largest increase occurred in accommodation and food services, followed by administrative and waste services, retail trade, professional and technical services, and health care and social assistance; the largest decrease occurred in construction.

During the second quarter of 2011, total government earnings increased \$418 million or 2.9 percent from the same quarter of 2010. Federal government earnings increased \$277 million or 3.0 percent in the second quarter of 2011. State and local governments showed a \$141 million or 2.7 percent increase in the quarter.

In the first half of 2011, Honolulu's Consumer Price Index for Urban Consumers (CPI-U) increased 3.5 percent from the same period in 2010, higher than the U.S. average CPI-U increase of 2.8 percent for the same period. The Honolulu CPI-U increase in the first half of 2011 was primarily due to relatively large increase in Other Goods and Services (7.0 percent), Transportation (6.8 percent), Recreation (3.7 percent), and Education and Communication (3.6 percent). The prices for Housing and Food & Beverages increased 2.9 percent and 2.6 percent, respectively, while the price for Medical Care increased only 0.2 percent compared to the first half of 2010.

Table 4

PERSONAL INCOME FOR HAWAII BY MAJOR SOURCES

[In millions of dollars at seasonally adjusted annual rates and percent. As of QSER September 2003, according to NAICS classification only]

Series	First Quarter 2010	Second Quarter 2010	First Quarter 2011	Second Quarter 2011	AnnAver 2009	AnnAver 2010	Percentage change from		
							To Second Quarter 2011 From		Ann Aver
							Second Quarter 2010	First Quarter 2011	2010 from 2009
PERSONAL INCOME	56,001	56,486	58,682	59,216	54,786	56,811	4.8	0.9	3.7
Earnings By Place of Work	40,891	41,252	42,320	42,534	40,399	41,508	3.1	0.5	2.7
Wage and salary disbursements	28,495	28,669	29,290	29,458	28,545	28,815	2.8	0.6	0.9
Supplements to wages and salaries	8,939	9,004	9,367	9,379	8,641	9,100	4.2	0.1	5.3
Emp'or contrib. for emp'ee pension & ins. funds	6,798	6,800	7,012	7,012	6,636	6,871	3.1	0.0	3.5
Employer contributions for gov't social ins.	2,141	2,204	2,355	2,367	2,005	2,230	7.4	0.5	11.2
Proprietors' income	3,457	3,580	3,664	3,698	3,214	3,593	3.3	0.9	11.8
Farm proprietors' income	47	50	43	39	81	67	-22.0	-9.3	-16.8
Nonfarm proprietors' income	3,410	3,530	3,621	3,659	3,134	3,526	3.7	1.0	12.5
Dividends, interest, and rent	10,693	10,787	11,184	11,411	10,365	10,744	5.8	2.0	3.7
Personal current transfer receipts	8,796	8,901	9,378	9,497	8,256	9,053	6.7	1.3	9.7
State unemployment insurance benefits	654	570	503	497	545	578	-12.8	-1.2	6.1
Personal current transfer receipts exc State U.I.	8,141	8,330	8,875	9,000	7,712	8,476	8.0	1.4	9.9
Less: Contributions for gov't social insurance	4,379	4,454	4,201	4,227	4,235	4,495	-5.1	0.6	6.1
Personal contributions for gov't social insurance	2,238	2,250	1,846	1,860	2,230	2,265	-17.3	0.8	1.5
Employer contributions for gov't social insurance	2,141	2,204	2,355	2,367	2,005	2,230	7.4	0.5	11.2
Earnings By Industry	40,891	41,252	42,320	42,535	40,400	41,508	3.1	0.5	2.7
Farm Earnings	271	274	277	266	276	292	-2.9	-4.0	5.5
Nonfarm Earnings	40,620	40,978	42,043	42,269	40,124	41,217	3.2	0.5	2.7
Private earnings	26,057	26,409	27,072	27,282	25,837	26,570	3.3	0.8	2.8
Forestry, fishing, related activities, and other 6/	41	41	44	44	42	41	7.3	0.0	-1.8
Mining	33	33	32	34	35	33	3.0	6.3	-5.1
Utilities	381	350	409	415	361	379	18.6	1.5	4.8
Construction	2,920	2,906	2,785	2,836	3,002	2,888	-2.4	1.8	-3.8
Manufacturing	744	744	780	781	747	747	5.0	0.1	-0.1
Durable goods	284	278	291	290	270	277	4.3	-0.3	2.6
Nondurable goods	460	465	488	491	477	469	5.6	0.6	-1.5
Wholesale trade	1,069	1,069	1,081	1,065	1,074	1,077	-0.4	-1.5	0.3
Retail trade	2,498	2,502	2,553	2,607	2,440	2,537	4.2	2.1	4.0
Transportation and warehousing	1,322	1,326	1,411	1,380	1,313	1,341	4.1	-2.2	2.2
Information	687	704	737	746	661	724	6.0	1.2	9.5
Finance and insurance	1,302	1,293	1,344	1,339	1,317	1,309	3.6	-0.4	-0.6
Real estate and rental and leasing	695	703	755	761	723	723	8.3	0.8	0.1
Professional and technical services	2,409	2,463	2,544	2,556	2,421	2,470	3.8	0.5	2.1
Management of companies and enterprises	638	609	657	677	607	618	11.2	3.0	1.9
Administrative and waste services	1,651	1,695	1,764	1,820	1,649	1,715	7.4	3.2	4.0
Educational services	654	661	656	651	640	660	-1.5	-0.8	3.1
Health care and social assistance	3,813	3,922	3,913	3,996	3,818	3,902	1.9	2.1	2.2
Arts, entertainment, and recreation	471	483	485	485	494	480	0.4	0.0	-2.8
Accommodation and food services	3,150	3,320	3,521	3,481	2,962	3,326	4.8	-1.1	12.3
Other services, except public administration	1,578	1,584	1,599	1,608	1,535	1,602	1.5	0.6	4.3
Government and government enterprises	14,564	14,569	14,971	14,987	14,286	14,647	2.9	0.1	2.5
Federal	9,284	9,352	9,602	9,629	8,796	9,377	3.0	0.3	6.6
Federal, civilian	3,467	3,561	3,572	3,592	3,249	3,542	0.9	0.6	9.0
Military	5,817	5,791	6,030	6,037	5,547	5,836	4.2	0.1	5.2
State and local	5,279	5,217	5,369	5,358	5,490	5,270	2.7	-0.2	-4.0

1/ 2008Q1 through 2011Q1 revised on September 22, 2011.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, State Quarterly Personal Income,

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Table 5

PERSONAL INCOME
(In millions of dollars at seasonally adjusted annual rates)

YEAR	ANNUAL AVERAGE	% CHANGE
2001	35,936	2.0
2002	37,475	4.3
2003	39,032	4.2
2004	42,285	8.3
2005	45,332	7.2
2006	49,124	8.4
2007	52,555	7.0
2008	55,296	5.2
2009	54,786	4.2
2010	56,857	3.8
2011*	58,949	3.7

* First half of 2011.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

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Table 6

**HONOLULU and U.S. CONSUMER PRICE INDEX,
ALL URBAN CONSUMERS (CPI-U)
[Percentage change from the same period last year]**

Period	U.S.	Honolulu								
		All Items	Food & Beverages	Housing	Apparel	Transportation	Medical Care	Recreation 1/	Educ. & Comm. 1/	Other Goods & Services
Percentage Change from the Same Period in Previous Year										
2001	2.8	1.2	2.9	0.7	-2.4	2.9	(2/)	-1.2	-1.8	3.4
2002	1.6	1.1	1.4	1.2	1.6	-2.1	(2/)	-2.1	3.1	4.5
2003	2.3	2.3	1.7	2.8	-4.0	3.2	(2/)	0.9	4.4	1.8
2004	2.7	3.3	3.0	4.4	2.7	3.4	(2/)	1.9	0.9	1.6
2005	3.4	3.8	3.2	5.6	1.3	5.0	(2/)	-4.4	0.7	2.8
2006	3.2	5.9	4.5	8.4	1.9	5.5	(2/)	3.4	-0.3	3.5
2007	2.8	4.8	5.5	7.2	-0.2	1.4	(2/)	1.5	0.0	4.6
2008	3.8	4.3	5.7	4.3	1.1	4.4	(2/)	2.6	2.8	5.2
2009	-0.4	0.5	3.6	0.4	7.2	-6.4	1.1	0.0	4.9	8.1
2010H1	2.1	2.5	-0.1	0.9	1.9	11.5	-0.3	0.9	4.1	4.7
H2	1.2	1.7	0.5	0.9	4.5	2.9	-0.6	3.4	5.1	5.5
2011H1	2.8	3.5	2.6	2.9	2.4	6.8	0.2	3.7	3.6	7.0

Data on U.S. CPI are released monthly and Honolulu CPI, twice a year in February and August for the half (H) year previous.

NA Not available.

1/ New indexes as of January 1998. Base period is December 1997. The former "Entertainment" index has been discontinued.

2/ No data were available or data did not meet U.S. Bureau of Labor Statistics' publication criteria.

Source: U.S. Bureau of Labor Statistics, Consumer Price Index-All Urban Consumers (Current Series) <<http://data.bls.gov/cgi-bin/dsrv>> and BLS Honolulu CPI News Releases and <<http://www.bls.gov/ro9/cpihono.htm>> accessed August 18, 2011.

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Tourism

Hawaii's tourism sector performance was mixed in the third quarter of 2011. The number of visitors arriving by air to Hawaii and the visitor days by air both decreased in the quarter; however, total visitor spending increased in the quarter. In the first three quarters of 2011, visitors arriving by air, visitor days by air, and total visitor spending all increased compared to the same period last year.

In the third quarter of 2011, domestic visitor arrivals by air decreased 46,073 or 3.3 percent; while international arrivals increased 29,550 or 5.8 percent. Since the increase in international arrivals was not enough to offset the decrease in domestic arrivals in the quarter, the total number of visitors arriving by air decreased 16,523 or 0.9 percent in the quarter. Due to slightly longer lengths of stay, the decrease in visitor days was lower than the decrease in visitor arrivals. In the third quarter of 2011, domestic visitor days decreased 432,250 days or 3.2 percent; while international visitor days increased 364,526 days or 9.4 percent; and total visitor days decreased 67,723 days or 0.4 percent. Since visitors spent more on a daily basis during the third quarter, total visitor spending increased \$246.1 million or 8.3 percent in the quarter.

In the first three quarters of 2011, total visitor arrivals by air increased 134,272 or 2.6 percent; total visitor days by air increased 2,035,712 days or 4.1 percent; and total visitor spending increased \$1,181.8 million or 14.7 percent compared with the same period of 2010. Arrivals on domestic flights increased 94,675 or 2.5 percent; arrivals on international flights increased 39,597 or 2.7 percent; domestic visitor days increased 1,226,950 days or 3.3 percent; international visitor days increased 808,761 days or 7.1 percent in the first three quarters of 2011.

In the third quarter of 2011, the statewide hotel occupancy rate averaged 75.9 percent, up 0.6 of a percentage point from the same quarter of 2010. In the first three quarters of 2011, the statewide hotel occupancy rate averaged 73.9 percent, up 2.8 percentage points from the same period of 2010.

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Table 7
VISITOR ARRIVALS BY AIR

Average Length of Stay, Visitor Days, Average Daily Census

	2007	2008	2009	2010	% change 2007-2008	% change 2008-2009	% change 2009-2010
Arrivals							
Total	7,496,820	6,713,436	6,420,448	6,982,425	-10.4%	-4.4%	8.8%
Domestic	5,582,530	4,901,893	4,672,001	5,022,883	-12.2%	-4.7%	7.5%
International	1,914,290	1,811,543	1,748,447	1,959,542	-5.4%	-3.5%	12.1%
Average Length of Stay							
Total	9.22	9.40	9.38	9.39	2.0%	-0.2%	0.1%
Domestic	9.87	10.10	10.09	10.04	2.3%	-0.1%	-0.4%
International	7.33	7.53	7.51	7.74	2.6%	-0.2%	3.0%
Visitor Days							
Total	69,135,310	63,130,133	60,255,061	65,598,078	-8.7%	-4.6%	8.9%
Domestic	55,100,441	49,497,350	47,121,337	50,435,228	-10.2%	-4.8%	7.0%
International	14,034,869	13,632,783	13,133,724	15,162,850	-2.9%	-3.7%	15.4%
Average Daily Census							
Total	189,412	172,487	165,082	179,721	-8.9%	-4.3%	8.9%
Domestic	150,960	135,239	129,100	138,179	-10.4%	-4.5%	7.0%
International	38,452	37,248	35,983	41,542	-3.1%	-3.4%	15.4%

Source: Hawaii Tourism Authority.

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Table 8**HOTEL OCCUPANCY RATE (%)**

<i>Year</i>	<i>First Quarter</i>	<i>Second Quarter</i>	<i>Third Quarter</i>	<i>Fourth Quarter</i>	<i>Annual Average</i>
In Percent					
2001	80.7	70.7	70.3	57.2	69.2
2002	71.7	67.9	72.5	67.1	69.7
2003	74.4	67.1	77.4	71.3	72.6
2004	80.2	75.7	81.5	73.4	77.7
2005	83.8	78.4	84.8	77.2	81.1
2006	83.6	78.2	82.5	74.1	79.5
2007	77.5	72.0	78.6	72.0	75.0
2008	78.7	68.8	70.5	63.8	70.4
2009	66.7	63.7	67.3	63.5	64.8
2010 1/	70.6	67.3	75.3	69.5	70.7
2011 1/	77.0	68.6	75.9	Year-to-Date	73.8

The 2nd, 3rd, and 4th Quarter averages are computed by Hawaii State Department of Business, Economic Development & Tourism from PKF-Hawaii monthly averages through January 1995 and Hospitality Advisors LLC monthly averages from February 1995. The 1st quarter and Annual are as released or revised.

1/ Source revises each month of previous year when current year is released.

Source: Hawaii State Department of Business, Economic Development & Tourism, PKF-Hawaii and Hospitality Advisors LLC.

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Construction and Real Estate

The indicators of Hawaii's construction industry were mostly negative in the third quarter of 2011. Both government contracts awarded and the value of private building authorizations decreased in the third quarter of 2011 compared with the same quarter of 2010. However, construction jobs increased in the quarter.

Construction was one of the major contributors to job growth in Hawaii over the past few years. From 2002 to 2007, construction job growth averaged 8.0 percent per year. In the fourth quarter of 2007, number of construction job reached a peak of 40,000 jobs. From the second quarter of 2008 to the first quarter of 2011; however, the quarter-over-quarter growth rate of construction jobs has been negative in all quarters. In the third quarter of 2011, the construction sector gained 400 jobs or 1.4 percent compared with the same quarter of 2010. In the first three quarters of 2011, construction job decreased 0.9 percent or 250 jobs from the same period of 2010.

In the third quarter of 2011, the total value of private building authorizations decreased \$14.7 million or 2.7 percent compared with the third quarter of 2010; the value of new residential permits was up \$10.4 million or 5.3 percent; that of new commercial and industrial permits was down \$1.8 million or 2.1 percent; and that of additions and alternations permits was down \$23.1 million or 8.6 percent, compared to the same quarter of 2010. In the first three quarters of 2011, total private building authorizations decreased \$188.1 million or 12.2 percent compared with the same period of 2010.

In the third quarter of 2011, the growth rates of the values of total private building permits by county were mixed. Private building permits decreased \$49.2 million or 12.3 percent in Honolulu; decreased \$9.8 million or 45.3 percent in Kauai, but increased \$20.9 million or 27.2 percent and \$23.4 million or 44.2 percent in Hawaii and Maui, respectively, in the quarter. In the first three quarters of 2011, building permits decreased \$147.0 million in Honolulu; decreased \$41.5 million in Hawaii County; decreased \$5.3 million in Kauai; but increased \$5.8 million in Maui County.

Government contracts awarded decreased \$228.1 million or 64.7 percent, and State Government CIP expenditures decreased \$49.6 million or 18.1 percent in the third quarter of 2011 compared to the same quarter of 2010. In the first three quarters of 2011, government contracts awarded decreased \$526.4 million or 66.7 percent, and State Government CIP expenditures decreased \$116.5 million or 13.5 percent compared with the same period of 2010.

In the third quarter of 2011, the single-family housing unit authorizations decreased 80 units compared to the third quarter of 2010; and multi-family units authorized increased 402 units compared to the same quarter of 2010. In the first three quarters of 2011, the single-family unit authorizations decreased 148 units, while the number of multi-family units authorized decreased 612 units, compared to the same period of 2010.

The Honolulu Construction Cost Indexes increased 2.3 percent for Single Family Residence and increased 2.2 percent for High-Rise Building in the third quarter of 2011 over that of 2010.

In Honolulu, in the first ten months of 2011, single-family home unit resales declined 2.7 percent. The median price for single-family home was \$570,000, down 4.4 percent compared with the same period in 2010. The condominium unit resales increased 1.5 percent. The median price for condominium unit was \$302,790, down 0.8 percent from the same period of 2010.

In Maui, in the first ten months of 2011, single-family home unit resales increased 8.6 percent. The median price for single-family home was \$435,000, down 5.4 percent compared with the same period in 2010. The condominium unit resales remained the same. The median price for condominium unit was \$320,000, down 16.9 percent from the same period of 2010.

Table 9

**ESTIMATED VALUE OF COMPLETED CONSTRUCTION, NEW PRIVATE
BUILDING AUTHORIZATIONS, AND GOVERNMENT CONTRACTS AWARDED
(In millions of dollars)**

Year	Contracting tax base 1/	Private Building Authorization 2/				Government Contracts Awarded
		Total Private Authorizations	Residential	Commercial & Industrial 3/	Additions & Alterations	
In Millions of Dollars						
2001	3,766.4	1,585.7	882.4	329.1	374.2	715.7
2002	4,275.0	1,772.0	1,112.9	254.2	404.9	768.3
2003	4,536.3	2,361.2	1,345.1	507.5	508.6	633.4
2004	4,921.5	2,726.5	1,767.7	303.3	655.6	1,384.6
2005	6,024.0	3,492.0	2,259.3	433.5	799.1	725.1
2006	7,223.3	3,770.1	1,811.8	732.0	1,226.2	853.8
2007	8,072.9	3,585.4	1,855.4	703.9	1,026.2	869.5
2008	7,987.1	2,906.6	1,381.6	427.1	1,097.9	952.8
2009	6,641.7	1,998.9	799.2	284.8	914.9	778.6
2010 1 Qtr.	1,427.0	455.3	235.4	53.1	166.9	83.1
2 Qtr.	1,301.9	537.3	184.9	123.5	228.9	353.7
3 Qtr.	1,487.7	552.4	196.3	84.3	271.8	352.6
4 Qtr.	1,373.2	435.3	162.5	116.6	156.2	268.2
2011 1 Qtr.	1,382.9	380.9	146.8	48.1	186.1	75.4
2 Qtr.	1,443.6	438.4	178.4	47.2	212.7	63.0
3 Qtr.	(NA)	537.7	206.7	82.5	248.6	124.5
Percentage Change from the Same Period in Previous Year						
2001	4.2	4.8	10.3	33.7	-19.7	-11.7
2002	13.5	11.7	26.1	-22.8	8.2	7.3
2003	6.1	33.3	20.9	99.7	25.6	-17.6
2004	8.5	15.5	31.4	-40.2	28.9	118.6
2005	22.4	28.1	27.8	43.0	21.9	-47.6
2006	19.9	8.0	-19.8	68.8	53.4	17.8
2007	11.8	-4.9	2.4	-3.8	-16.3	1.8
2008	-1.1	-18.9	-25.5	-39.3	7.0	9.6
2009	-16.8	-31.2	-42.2	-33.3	-16.7	-18.3
2010 1 Qtr.	-19.8	-16.0	-14.8	36.7	-26.5	-50.3
2 Qtr.	-24.6	14.2	15.2	26.9	7.6	79.3
3 Qtr.	-5.8	-1.2	1.5	49.1	-12.0	50.8
4 Qtr.	-11.7	1.9	-3.9	26.6	-6.0	48.7
2011 1 Qtr.	-3.1	-16.4	-37.7	-9.5	11.5	-9.2
2 Qtr.	10.9	-18.4	-3.5	-61.8	-7.1	-82.2
3 Qtr.	(NA)	-2.7	5.3	-2.1	-8.6	-64.7

1/ Formerly, this category was "Value of Construction Completed", subject to revision by Hawaii State Department of Taxation.

2/ Beginning in 2002 Kauai data available for residential only.

3/ Includes hotels.

Source: Hawaii State Department of Taxation; county building departments; U.S. Census Bureau; First Hawaiian Bank; *Building Industry*.

Table 10

**ESTIMATED VALUE OF PRIVATE BUILDING
CONSTRUCTION AUTHORIZATIONS, BY COUNTY**

<i>Year</i>	<i>State</i>	<i>City & County of Honolulu</i>	<i>Hawaii County</i>	<i>Kauai County 1/</i>	<i>Maui County</i>
In Thousands of Dollars					
2002	1,772,027	876,049	449,601	172,660	273,716
2003	2,361,233	1,109,568	629,147	153,242	469,277
2004	2,726,536	1,320,552	826,494	130,659	448,831
2005	3,491,964	1,364,030	1,008,386	288,132	831,416
2006	3,770,051	1,625,328	926,019	239,294	979,412
2007	3,585,447	1,676,232	912,529	268,915	727,772
2008	2,906,578	1,481,272	704,317	277,149	443,840
2009	1,998,908	1,247,196	309,165	218,111	224,437
2010	1,980,296	1,357,314	360,328	68,047	194,607
2011 1 Qtr.	380,874	262,764	66,539	17,222	34,348
2 Qtr.	438,364	313,380	69,836	16,353	38,795
3 Qtr.	537,695	351,662	97,829	11,838	76,366
Percentage Change From The Same Period in Previous Year					
2002	11.7	28.3	18.2	28.6	-12.5
2003	33.3	26.7	39.9	-11.2	71.4
2004	15.5	19.0	31.4	-14.7	-4.4
2005	28.1	3.3	22.0	120.5	85.2
2006	8.0	19.2	-8.2	-16.9	17.8
2007	-4.9	3.1	-1.5	12.4	-25.7
2008	-18.9	-11.6	-22.8	3.1	-39.0
2009	-31.2	-15.8	-56.1	-21.3	-49.4
2010	-0.9	8.8	16.5	-68.8	-13.3
2011 1 Qtr.	-16.4	-13.3	-32.7	4.6	-7.5
2 Qtr.	-18.4	-15.5	-30.2	29.8	-27.7
3 Qtr.	-2.7	-12.3	27.2	-45.3	44.2

1/ Beginning with 2002, Kauai data available for residential only.

Source: County building departments.

Federal Government and Military

The Federal government plays an important role in Hawaii's economy. According to the most recent data available, total federal direct expenditures or obligations in Hawaii reached \$20.9 billion in the federal fiscal year ending September 30, 2010, an increase of 9.8 percent over the previous year. Between federal fiscal years 2000 and 2010, the annual average growth rate for federal expenditures was approximately 8.7 percent.

In 2010, total federal government compensation of employees in Hawaii reached \$9.4 million, an increase of 6.6 percent from 2009. Federal government compensation of employees in Hawaii accounted for approximately 24.7 percent of total compensation of employees in 2010. Between 2000 and 2010, the annual average growth rate for federal government compensation of employees in Hawaii was 7.4 percent. Federal military accounted for 62.2 percent of the total federal compensation of employees in Hawaii in 2010. According to the most recent data available, federal government accounted for about 14.5 percent of State GDP in Hawaii in 2010, much of which is defense-related.

The latest data from the U.S. Department of Commerce indicate that the total earnings of federal government personnel in the first quarter of 2011 increased 4.3 percent compared to the same quarter of 2010. For the whole year of 2010, total earnings of federal government personnel increased 5.4 percent from the previous year. In 2010, total military earnings and total federal civilian earnings increased 5.6 percent and 5.1 percent, respectively, from the previous year.

Between FY 2007-2009, the Department of Defense's (DoD) direct expenditures in Hawaii averaged \$6.5 billion per year (in 2009 dollars), with approximately \$4.1 billion for personnel and \$2.3 billion for procurement. Importantly, such expenditures generated output of \$12.2 billion for Hawaii's economy in 2009, representing over 18% of total spending in the State.

The majority of defense procurement in Hawaii is purchased by the Navy and Army, accounting for nearly 73% of the total spending (approximately \$1.7 billion). Defense procurement was relatively constant from 1982 to 1995, but grew steadily thereafter. The majority of procurement spending was in four areas: construction (\$787 million); professional, scientific and technical (\$457 million); administrative and support services (\$192 million); and petroleum and coal products manufacturing (\$176 million).

In 2009, 10% of the State's total employment was comprised of active duty and DoD civilian personnel. More than 75,000 people served in the military or were employed by DoD, comprised of 48,000 active duty services members, 18,000 DoD civilian employees, and 9,000 National Guard and Reserve members. The median earnings for active-duty service members and DoD civilians are higher than that of other full-time employees in Hawaii. In 2007-2009, the median salary for active duty personnel was \$74,900, while the median salary for DoD civilian workers was \$69,800 (in 2009 dollars). State income taxes attributed to these employees have generated more than \$113 million of tax revenues for Hawaii during this time period.

A major contributing factor to military constructions over the past five years have been the Public/Private Venture military housing partnership between the Army and Air Forces with Actus Lend Lease and Department of the Navy (Navy and Marine housing) partnership with Forest City. Demand for new military housing is expected to continue to support economic growth in Hawaii. Most of the construction efforts will focus on the Army's housing projects ranging from Fort Shafter to Helemano Military Reservation and Schofield Barracks, \$1.2 billion worth of military construction projects by Actus Lend Lease are expected to generate about 7,200 construction jobs.

Future levels of federal funding (including defense funding) in Hawaii are subject to potential spending cutbacks and deferrals that may be implemented to reduce the federal budget deficit.

Banks and Other Financial Institutions

As of December 31, 2010, total assets of all State chartered financial institutions, including banks, savings and loan associations and industrial loan companies, were reported at \$33.08 billion, a 3.85% increase from December 31, 2009. The five State chartered banks accounted for \$32.50 billion of such assets.

Transportation

Because the State's population resides on seven islands, the State is dependent on fast, efficient, low cost transportation, both interstate and intrastate.

Sea Transportation. The State is dependent on regular shipping service for overseas lifeline support. While nearly all visitors to the State arrive by air, sea transportation provides the State with the bulk of both its imported goods and delivery of exported local products. Overseas and inter-island cargo shipments for the fiscal years 2007, 2008, 2009 and 2010 amounted to 21.5 million short tons, 21.1 million short tons, 18.3 million short tons and 17.7 million short tons, respectively.

The Harbors System is comprised of ten commercial harbors, which are operated and maintained by the Department of Transportation as a single integrated system for financial and management purposes. The harbors are: (1) Honolulu Harbor, and Kalaeha Harbor on the island of Oahu, comprising the Oahu District; (2) Hilo Harbor and Kawaihae Harbor on the island of Hawaii, comprising the Hawaii District; (3) Nawiliwili Harbor and Port Allen Harbor on the island of Kauai, comprising the Kauai District; (4) Kahului Harbor and Hana Harbor on the island of Maui, Kaunakakai Harbor on the island of Molokai, and Kaunapali Harbor on the island of Lanai, comprising the Maui District. The Harbors System previously managed Kewalo Basin for its landowner, the Hawaii Community Development Authority ("HCDA"). Effective March 1, 2009, HCDA assumed management and operations of Kewalo Basin. Kewalo Basin's inclusion as a program under the Harbors System ceased on

June 30, 2009. Act 200, SLH 2008, authorized the transfer of Hana Harbor on the island of Maui to the jurisdiction of the Harbors System, effective July 1, 2008.

The State uses nine harbors, with the exception of Hana Harbor, to facilitate the movement of goods from and between the mainland, foreign and inter island ports. The number of commercial vessels entering all ports was 10,541 in fiscal year 2007, 11,005 in fiscal year 2008, 10,033 in fiscal year 2009 and 7,832 in fiscal year 2010. The U.S. Military moves most of its cargo through the State's Harbors System.

Honolulu Harbor is the hub of the Statewide Commercial Harbors System. It serves as a major distribution point of overseas cargo to the neighbor islands and is the primary consolidation center for the export of overseas cargo. Overseas and inter-island cargo tonnage handled through Honolulu Harbor was 10.2 million short tons in fiscal year 2007, 10.1 million short tons in fiscal year 2008, 8.9 million short tons in fiscal year 2009 and 8.9 million short tons in fiscal year 2010. The State manages, maintains and operates the statewide harbors system to provide for the efficient movement of cargo and passengers.

Act 200, SLH 2008, was enacted to authorize a statewide Harbors Modernization Plan ("HMP") to address harbor infrastructure improvements to Kahului Harbor on Maui, Nawiliwili Harbor on Kauai, Hilo and Kawaihae Harbors on Hawaii, and Honolulu and Kalaeloa Harbors on Oahu. In addition to the six commercial harbors included in the plan, the law placed Hana Harbor on Maui under the jurisdiction of the Harbors System and included appropriations for its upgrade. Act 200 also designated the Aloha Tower Development Corporation ("ATDC") as the entity responsible for the management and implementation of the HMP under the direction of the Department of Transportation. Act 200 authorizes the Department of Transportation to issue harbor revenue bonds to finance the improvements. The cost of the HMP is estimated at \$618 million. ATDC's failure to obtain legislative approval for operating funds for fiscal year 2011 effectively terminated its operations on June 30, 2010. The Harbors Division assumed management and implementation responsibilities of the HMP. Act 152, SLH 2011 placed the ATDC under the Department for administrative purposes and repealed references to the HMP. The Deputy Director-Harbors currently serves as the Chief Executive Officer for the ATDC. The modernization projects have been integrated into the administration's New Day Work Projects, a capital improvements program comprised of priority public works projects deemed critical to create jobs and jumpstart the economy.

Air Transportation. The State operates and maintains 15 airports on six islands within the State. The principal airport which provides facilities for overseas flights (i.e., other than inter-island flights within the State) is Honolulu International Airport (HNL) on the island of Oahu. HNL is located approximately five miles by highway from the center of the downtown area of Honolulu. It has four runways, two of which (12,000 feet and 12,300 feet) are among the nation's longest. Approximately 60 aircraft can be handled at one time at the terminal complex, including 36 wide bodied aircraft. With 29 overseas gate positions, 18 inter-island and commuter positions and public parking stalls increasing from 4,579 to 6,379 vehicles as a result of a new parking structure opened in February 2009 at HNL. HNL is the most important in the State airports system. The airfield at Barber's Point Naval Air Station became Kalaeloa Airport, a general aviation reliever airport for HNL, in July 1999.

Kahului Airport on the island of Maui, Hilo International Airport (renamed from General Lyman Field) at Hilo and Kona International Airport at Keahole (both on the island of Hawaii), and Lihue Airport on the island of Kauai, also service direct flights to and from the continental United States.

In fiscal year 2011, HNL recorded 267,967 aircraft operations as compared to 263,425 for fiscal year 2010. In addition, HNL passenger counts for fiscal year 2011 decreased from 18,238,865 in fiscal year 2010 to 18,093,194. The decreases are a reflection of the worldwide economic recession.

Until March 31, 2008, inter-island air travel in Hawaii was primarily served by Aloha Airlines and Hawaiian Airlines. In June 2006, Mesa Air Group began inter island service as go! Airlines. On March 20, 2008, Aloha Airlines, Inc. filed a petition for relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court of the District of Hawaii. On March 31, 2008, Aloha Airlines ceased all passenger operations. On April 29, 2008, Aloha Airlines, which had handled approximately 85% of Hawaii's inter-island air cargo, ceased all air cargo operations as well as maintenance cleaning services. Almost immediately thereafter, such operations were taken over by Aeko Kula, Inc. (cargo) and Aloha Contract Services LLC (maintenance services). In October 2008, Mokulele Airlines expanded its inter-island service utilizing a portion of the former Aloha Airlines

hold rooms and baggage areas. Effective October 15, 2009, go! Airlines and Mokulele Airlines consolidated their operations and are operating as go! Mokulele Airlines.

The Airports Division's modernization program is under way and includes significant capital improvements for several of the major airports in the State, including Honolulu, Kahului, Kona and Lihue. The program is currently estimated to cost \$1.4 billion through 2016 and will be paid for from a variety of sources including cash, grants, passenger facility charges and revenue bonds.

Land Transportation. In the State, three levels of government have authority to construct and maintain public highways, streets and roads. These levels of government are the State, the counties and various federal agencies. The State is served by approximately 4,276.9 linear miles of public highways, streets and roads administered by the Department of Transportation and the counties. An additional 117.6 miles of public highways, streets and roads open to the public in national parks and military reservations are the responsibility of various federal agencies, including the United States National Park Service and the military services.

The State Highway System, which is administered by the Department of Transportation, consists of 946 linear miles of roadways. The most important component of the State Highway System is the 55 miles of interstate system on Oahu, which includes Interstates H-1, H-2, H-3 and H-201.

The City and County of Honolulu is proceeding with plans for a new \$5.3 billion, 20-mile fixed guideway mass transit system to provide rail service along Oahu's east-west corridor between Kapolei and downtown Honolulu (terminating at Ala Moana Shopping Center). Construction of the project is expected to be funded with the City and County of Honolulu surcharge of ½ of 1% imposed upon Oahu activities subject to the 4% General Excise and Use Taxes and federal monies. Construction and operation of this System is the sole responsibility of the City and County of Honolulu.

See also Appendix B – “ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES, THE STATE HIGHWAY SYSTEM AND THE DEPARTMENT OF TRANSPORTATION” for a more detailed description of the State Highway System.

Education

The State operates a statewide public school system for elementary, intermediate, and high schools and colleges and universities. In the 2011-2012 school year, system enrollment increased from a total of 178,189 in the 2010-2011 school year to a total of 181,213 in 286 K-12 public schools (includes 31 charter schools). The public education system at all levels (elementary, intermediate, high school, colleges and universities) is financed at the State level rather than the local level. This includes both capital outlays and costs of operation. Within the total student count, the number of students in Department of Education schools has decreased and the number of students in charter schools has increased.

The University of Hawaii was established in 1907 on the model of the American system of land grant universities created initially by the Morrill Act of 1862. In the 1960s and 1970s, the University was developed into a system of accessible and affordable campuses. These institutions currently include:

- (i) a research university at Manoa, offering a comprehensive array of undergraduate, graduate and professional degrees through the doctoral level, including law, and a medical school and new cancer research center (scheduled completion in early 2013) at Kakaako in downtown Honolulu;
- (ii) a comprehensive, primarily baccalaureate institution at Hilo, offering professional programs based on a liberal arts foundation and selected graduate degrees; a College of Pharmacy with a four-year curriculum leading to a Doctor of Pharmacy degree, seated its inaugural class in the fall of 2007;
- (iii) a baccalaureate institution at West Oahu, offering degrees in the liberal arts and professional studies; and

(iv) a system of seven open door community colleges spread across the islands of Kauai, Oahu, Maui and Hawaii, offering quality liberal arts and workforce programs.

In the fall of 2009, 57,945 students attended the University of Hawaii system, 20,435 of them on the Manoa Campus. In the fall of 2010, 60,090 students attended the University of Hawaii system, 20,337 of them on the Manoa campus. In the fall of 2011, 60,330 students attended the University of Hawaii System, 20,429 of them on the Manoa campus.

State Housing Programs

Since 1970, the State has undertaken a program to alleviate the shortage of housing in the State under a comprehensive housing law. The law recognizes that all phases of housing are related to one another and consequently attempts to cover all such phases, from construction through permanent financing, and also attempts to solve or mitigate the housing problem by using both the public and private sectors. To this end the State has undertaken, among other things, facilitating the development of real property and the construction of dwelling units thereon in partnerships with qualified developers and contractors. The State's participation in such partnerships has consisted of construction financing (interim financing), including land acquisition. Other State efforts include construction and permanent financing for developers of residential housing; development by the State itself of single and multifamily residential housing units on land owned by the State or on land purchased or to be purchased for such purpose or on land to be leased from others; and loans to qualified residents of the State who are qualified purchasers of affordable dwelling units.

The State also administers federal and state housing assistance programs for low income families. Included are the management of low rent public housing units, the administration of the Section 8 tenant based housing assistance program and other federal and State programs intended to provide very low to low income residents with safe, decent and sanitary housing.

The State housing programs previously were carried out by the Housing and Community Development Corporation of Hawaii (the "HCDCH"). On July 1, 2006, pursuant to Act 196, SLH 2005, as amended by Act 180, SLH 2006, the HCDCH was bifurcated into the Hawaii Public Housing Authority (the "HPHA") and the Hawaii Housing Finance and Development Corporation (the "HHFDC"). The assets, obligations and functions of the HCDCH were transferred to the HHFDC and to the HPHA, as provided by such Acts. The HHFDC performs the function of housing finance and development. The HHFDC is empowered to raise funds through the issuance of revenue bonds and to use such funds for housing purposes. The bonds are special obligations of the HHFDC and do not impact the debt limit of the State, nor do the bonds constitute general obligations of the State. The HPHA performs the function of developing and maintaining public housing.

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APPENDIX D

**FINANCIAL STATEMENTS FOR THE YEAR ENDED JUNE 30, 2010
AND INDEPENDENT AUDITORS' REPORT**

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A Hawaii Limited Liability Partnership

Independent Auditor's Report

Office of the Auditor
State of Hawaii:

We have audited the accompanying financial statements of the governmental activities and each major fund of the Highways Division of the Department of Transportation of the State of Hawaii (Division), as of and for the year ended June 30, 2010, which collectively comprise the Division's basic financial statements as listed in the preceding table of contents. These financial statements are the responsibility of the Division's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1, the financial statements of the Division are intended to present the financial position and the changes in financial position of only that portion of the governmental activities and each major fund of the State of Hawaii that is attributable to the transactions of the Division. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2010, and the changes in its financial position for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Division, as of June 30, 2010, and the respective changes in financial position and the respective budgetary comparison of the State Highway Fund thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated March 29, 2011, on our consideration of the Division's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit

performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 8 through 19 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Division's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.



KMH LLP

Honolulu, Hawaii
March 29, 2011

State of Hawaii, Department of Transportation – Highways Division

Management's Discussion and Analysis – Unaudited
As of and for the Year Ended June 30, 2010

The following Management's Discussion and Analysis ("MD&A") of the Highways Division, Department of Transportation, State of Hawaii ("Division") activities and financial performance provides the reader with an introduction and overview to the financial statements of the Division for the year ended June 30, 2010. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

The Territorial Highway Department was created by the Territorial Legislature on April 24, 1925 by Act 78 to qualify Hawaii for participation in the Federal-Aid Program. The purpose of the Federal-Aid Program was to ensure the development of an integrated network of highways in the United States. Congress defined that the Federal government would provide the funds for construction on a matching contribution basis while the State or its political subdivisions would administer the highway.

The Department of Transportation was created in 1959 by the Hawaii State Government Reorganization Act. In creating the new department, the legislature transferred the responsibilities of the old Highway Department to the Highways Division of the new Department of Transportation.

The mission of the Division is to facilitate the rapid, safe, and economical movement of people and goods within the State by providing, maintaining, and operating land transportation facilities and support services. The major goals of the Division are to plan, design, construct, and maintain highway facilities. In addition, the Division, together with the Statewide Transportation Planning Office, implements innovative and diverse approaches to congestion management to increase the efficiency of the transportation system.

The Division is managed by the Division Administrator. Each island in the system is managed by a district manager with the exception of the Maui District, which includes the islands of Molokai and Lanai. The Staff Services Office, headed by the Administrative Services Officer, is responsible for personnel, budget, procurement, financial management, method, standards and evaluation functions of the Division. Other major functional operations within the Division include Project Coordination and Technical Services Office, Engineering Services Office, Landscape Services Office, Motor Vehicle Safety Office, Planning Branch, Design Branch, Rights-of-Way Branch, Materials Testing and Research Branch, Construction and Maintenance Branch, and Traffic Branch.

State of Hawaii, Department of Transportation – Highways Division

Management's Discussion and Analysis – Unaudited
As of and for the Year Ended June 30, 2010

FINANCIAL HIGHLIGHTS

Government-wide Financial Statements

The assets of the Division exceeded its liabilities at June 30, 2010 by \$5.1 billion. Of this amount, \$184 million is considered unrestricted and may be used to meet the Division's ongoing obligations.

The current year change in net assets was a decrease of \$87 million. This resulted from a deficiency of revenues under expenditures of \$79 million and a transfer of \$8 million to other State departments for debt service payments on general obligation bonds. The deficiency of revenues under expenditures was significantly impacted by depreciation expense of \$220 million.

Fund Financial Statements

At June 30, 2010, the Division's Governmental Funds reported a combined ending fund balance of \$222 million. The combined fund balance decreased by \$84 million from the prior year's ending fund balance.

The Division's State Highway Fund (SHF), the major operating fund, reported an ending fund balance of \$140 million, of which \$32 million is considered unreserved. There was a \$26 million decrease in fund balance for the year ended June 30, 2010.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Division's basic financial statements. The Division's basic financial statements consist of three sections: 1) government-wide financial statements, 2) fund financial statements and 3) notes to the financial statements. These sections are described as follows:

State of Hawaii, Department of Transportation – Highways Division

Management's Discussion and Analysis – Unaudited
As of and for the Year Ended June 30, 2010

Government-wide Financial Statements

The government-wide statements report information about the Division as a whole in a manner similar to a private-sector business. The statements provide both long-term and short-term information about the Division's overall financial status. They are prepared using the economic resources measurement focus and the accrual basis of accounting. They take into account all revenues and expenses connected with the fiscal year, regardless of when cash is received or paid. The government-wide financial statements include the following two statements:

The Statement of Net Assets presents all of the Division's assets and liabilities, with the difference between the two reported as "net assets." Over time, increases or decreases in the Division's net assets are an indicator of whether its financial health is improving or deteriorating.

The Statement of Activities presents information showing how the Division's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods.

The Division's activities are considered governmental activities, and are primarily funded by taxes, charges for services, and intergovernmental revenues.

The government-wide financial statements can be found on pages 20 to 22 of this report.

Fund Financial Statements

A fund is a grouping of related accounts that are used to maintain control over resources that have been segregated for specific activities or objectives. The Division, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All funds of the Division are considered governmental funds.

The fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on the balances of spendable resources available at the end of the fiscal year. Fund financial statements are prepared using the current financial resources measurement focus and the modified-accrual basis of accounting. These statements provide a detailed short-term view of the Division's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of the Division.

State of Hawaii, Department of Transportation – Highways Division

Management's Discussion and Analysis – Unaudited
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Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Division's near-term financing decisions. A reconciliation to facilitate this comparison between governmental fund financial statements and government-wide financial statements is included on pages 25 and 28 of this report.

The Division has three governmental funds, all of which are considered major funds for presentation purposes. That is, each major fund is presented in a separate column in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures, and changes in fund balances. The Division's three governmental funds are the SHF (a Special Revenue Fund), the Debt Service Fund, and the Capital Projects Fund.

The basic governmental funds financial statements can be found on pages 23 through 28 of this report.

Statement of Revenues and Expenditures—Budget and Actual—State Highway Fund (Non-GAAP Budgetary Basis)

The governmental funds financial statements are followed by a budgetary comparison statement, which compares the SHF's original budget, final budget, and actual amounts prepared on a budgetary basis. A reconciliation between the actual SHF revenues and expenditures compared to the SHF revenues and expenditures prepared for budgetary purposes is included in Note 3 to the financial statements.

The Statement of Revenues and Expenditures—Budget and Actual—State Highway Fund (Non-GAAP Budgetary Basis) can be found on page 29 of this report.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and the governmental funds financial statements. The notes to the financial statements can be found on pages 31 through 59 of this report.

**State of Hawaii,
Department of Transportation – Highways Division**

Management's Discussion and Analysis – Unaudited
As of and for the Year Ended June 30, 2010

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Statements of Net Assets

As noted earlier, net assets may serve over time as a useful indicator of the Division's financial position. The Division's assets exceeded liabilities by \$5.1 billion and \$5.2 billion at June 30, 2010 and 2009, respectively.

	2010	2009
Assets		
Current and other assets	\$ 311,344,876	\$ 403,527,855
Capital assets – net of accumulated depreciation	5,263,440,778	5,287,349,669
Total assets	<u>\$ 5,574,785,654</u>	<u>\$ 5,690,877,524</u>
Liabilities		
Current liabilities	\$ 93,759,323	\$ 92,445,019
Long-term liabilities	356,080,509	386,705,203
Total liabilities	<u>449,839,832</u>	<u>479,150,222</u>
Net Assets		
Invested in capital assets—net of related debt	4,907,506,483	4,946,587,525
Restricted	33,243,020	36,024,437
Unrestricted	184,196,319	229,115,340
Total net assets	<u>5,124,945,822</u>	<u>5,211,727,302</u>
Total liabilities and net assets	<u>\$ 5,574,785,654</u>	<u>\$ 5,690,877,524</u>

The largest portion of the Division's net assets (96 and 95 percent at June 30, 2010 and 2009) reflects its investment in capital assets (e.g., land and land improvements, buildings and improvements, vehicles and equipment, and infrastructure), less any related debt used to acquire those assets that is still outstanding. The Division uses these capital assets to provide services to citizens; therefore, these assets are not available for future spending. Although the Division's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay the debt must be provided from other sources, since capital assets themselves cannot be used to liquidate these liabilities.

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An additional portion of the Division's net assets (0.6 percent and 0.7 percent at June 30, 2010 and 2009, respectively) represents resources that are subject to restrictions as to how they may be used. This primarily relates to net assets reserved for payment of the Division's revenue bond debt service. The remaining balance of unrestricted net assets may be used to meet the Division's on-going obligations to citizens and creditors.

Capital assets – net decreased by \$25 million from June 30, 2009 to June 30, 2010 and by \$20 million from June 30, 2008 to June 30, 2009 primarily because depreciation expense more than offset additions to construction in progress.

Long-term liabilities decreased by \$31 million from June 30, 2009 to June 30, 2010 primarily due to principal payments on revenue bonds and increased by \$109 million from June 30, 2008 to June 30, 2009, primarily due to issuance of Hawaii Revenue Bonds, Series 2008.

**State of Hawaii,
Department of Transportation – Highways Division**

Management's Discussion and Analysis – Unaudited
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Statements of Activities

The following condensed financial information was derived from the government-wide Statements of Activities and reflects how the Division's net assets changed during the year.

	<u>2010</u>	<u>2009</u>
EXPENSES:		
Program expenses:		
Operations and maintenance	\$ 153,837,337	\$ 211,309,768
Administration of Highways		
Division	51,756,737	7,789,571
Surcharge on gross receipts	6,980,997	7,343,493
Motor Vehicle Safety Office	9,070,726	10,047,170
Capital projects	1,049,435	15,923,884
Depreciation expense	220,434,833	221,934,320
Debt service/interest expense	16,932,672	15,066,810
Total expenses	<u>460,062,737</u>	<u>489,415,016</u>
REVENUES:		
Program revenues:		
Charges for services	26,029,431	28,159,153
Operating grants and contributions	54,350,963	72,915,021
Capital grants and contributions	125,689,095	151,639,687
Total program revenues	<u>206,069,489</u>	<u>252,713,861</u>
General revenues:		
Taxes	154,530,300	159,300,992
Investment income (loss)	19,893,227	(4,075,865)
Other	834,261	1,083,710
Total general revenues	<u>175,257,788</u>	<u>156,308,837</u>
Total revenues	<u>381,327,277</u>	<u>409,022,698</u>
Decrease in net assets before transfers (Carried forward)	<u>\$ (78,735,460)</u>	<u>\$ (80,392,318)</u>

**State of Hawaii,
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	<u>2010</u>	<u>2009</u>
Decrease in net assets before transfers (Brought forward)	\$ (78,735,460)	\$ (80,392,318)
Transfers	<u>(8,046,020)</u>	<u>(13,081,893)</u>
Decrease in net assets	(86,781,480)	(93,474,211)
Net Assets, beginning of year	<u>5,211,727,302</u>	<u>5,305,201,513</u>
Net Assets, end of year	<u><u>\$ 5,124,945,822</u></u>	<u><u>\$ 5,211,727,302</u></u>

Program revenues, which comprise charges for services as well as operating and capital grants, accounted for 54 percent and 62 percent of total revenues in fiscal years 2010 and 2009, respectively. The largest components of program revenues (87 percent and 89 percent for fiscal years 2010 and 2009) resulted from operating and capital grants and contributions from the Federal Highway Administration for the maintenance and construction of roads and other infrastructure.

Revenues not classified as program revenues are considered general revenues and primarily consist of taxes.

The fiscal year 2010 decrease in net assets of \$87 million resulted from the excess of expenses over revenues of \$79 million due primarily to depreciation expense of \$220 million and a transfer out of \$8 million to other State departments for the payment of debt service on general obligation bonds.

The fiscal year 2009 decrease in net assets of \$93 million resulted from the excess of expenses over revenues of \$80 million due primarily to depreciation expense of \$222 million and a transfer out of \$13 million to other State departments for the payment of debt service on general obligation bonds.

FINANCIAL ANALYSIS OF THE DIVISION'S GOVERNMENTAL FUNDS

As noted earlier, the Division uses fund accounting to ensure and demonstrate compliance with finance-related requirements.

The focus of the Division's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Division's financing requirements.

State of Hawaii, Department of Transportation – Highways Division

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At June 30, 2010, the Division's Governmental Funds reported combined ending fund balances of \$222 million, representing a decrease of \$84 million from the prior year. Substantially all of the fund balance is reserved to indicate that it is not available for new spending primarily because it has already been committed to liquidate contracts and purchase orders of the prior period.

At June 30, 2009, the Division's Governmental Funds reported combined ending fund balances of \$306 million, representing a increase of \$33 million from the prior year. Substantially all of the fund balance is reserved to indicate that it is not available for new spending primarily because it has already been committed to liquidate contracts and purchase orders of the prior period.

The SHF is the major operating fund of the Division. The State imposes taxes, fees, and charges relating to the operation and use of motor vehicles on the public highways of the State. These funds are deposited into the SHF established under Section 248-8, Hawaii Revised Statutes ("HRS"). Monies deposited in the SHF are used for acquisition, planning, design, construction, operation, repair, and maintenance of the State Highway System.

The current taxes, fees, and charges deposited to the SHF consist of: (1) the highway fuel taxes; (2) vehicle registration fees; (3) the vehicle weight tax; and (4) the rental motor vehicle and tour vehicle surcharge taxes. Together, these taxes, fees and charges accounted for most of the receipts of the SHF. Other sources of revenues include interest earnings on monies previously credited to the SHF, vehicle weight tax penalties, certain rental income from State Highway System properties, passenger motor vehicle inspection charges, overweight permits, sales of surplus lands, commercial license fees, and other miscellaneous revenues.

At June 30, 2010, the total fund balance of the SHF was \$140 million, of which \$32 million was unreserved. As a measure of the SHF's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures (including transfers out). Unreserved fund balance represents 11 percent of total fund expenditures (including transfers out), while total fund balance represents 50 percent of the same amount.

The SHF's fund balance decreased by \$26 million in the current year compared to a \$56 million decrease in the prior year. During the current year, the Division collected fewer revenues and also expended more for operations and maintenance.

At June 30, 2009, the total fund balance of the SHF was \$166 million, of which \$30 million was unreserved. As a measure of the SHF's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures (including transfers out). Unreserved fund

State of Hawaii, Department of Transportation – Highways Division

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balance represents 10 percent of total fund expenditures (including transfers out), while total fund balance represents 53 percent of the same amount.

The SHF's fund balance decreased by \$56 million in fiscal year 2009. During that fiscal year, the Division collected fewer revenues and also expended more for operations and maintenance.

The Debt Service Fund ("DSF") is used to track the revenue bond debt service for the Division. Debt service requirements are transferred from the SHF. The increase in debt service expense on the government-wide financial statements from \$32 million in fiscal year 2009 to \$39 million in fiscal year 2010 is attributable to increased interest expense.

The Capital Projects Fund ("CPF") accounts for the Division's capital improvements program. At June 30, 2010, the CPF had a total fund balance of \$82 million, including an unreserved fund deficit of \$198 million. The CPF fund balance decreased by \$58 million in fiscal year 2010 compared to a \$89 million increase in the prior year. The change from the prior year was due primarily to an increase in contract encumbrances in the current year.

STATE HIGHWAY FUND BUDGETARY HIGHLIGHTS

The final SHF budget had total revenues of \$198 million which is equal to the original budget. The actual revenues on a budgetary basis were \$13 million less than the final budget, primarily due to a decrease in rental motor and tour vehicle surcharge tax and interest income.

Expenditures on the budgetary actual basis were \$3.3 million lower than the final budgeted amounts. The difference was primarily due to significant repairs and maintenance work that was budgeted being deferred into future periods.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The Division's investment in capital assets as of June 30, 2010 amounted to \$5.3 billion, net of accumulated depreciation of \$4.4 billion. This investment in capital assets includes land and land improvements, buildings and building improvements, vehicles and equipment, infrastructure assets and construction in progress. Infrastructure assets consist of land, roadways, tunnels and bridges, and miscellaneous roadway components.

State of Hawaii, Department of Transportation – Highways Division

Management's Discussion and Analysis – Unaudited
As of and for the Year Ended June 30, 2010

During fiscal year 2010, the Division put out 22 projects to bid with a contract amount of approximately \$261 million. There were 6 projects on Oahu, 9 projects on Hawaii, 4 projects on Maui, (includes Molokai and Lanai), and 3 projects on Kauai.

During fiscal year 2009, the Division put out 40 projects to bid with a contract amount of approximately \$153 million. There were 14 projects on Oahu, 5 projects on Hawaii, 9 projects on Maui, (includes Molokai and Lanai), and 12 projects on Kauai.

At June 30, 2010, the Division had \$280 million in contracts encumbered in the Capital Projects Fund. This amount represents projects in the in-house planning stage and contracts awarded in fiscal year 2010, with construction expected to start in fiscal year 2010.

At June 30, 2009, the Division had \$294 million in contracts encumbered in the Capital Projects Fund. This amount represents projects in the in-house planning stage and contracts awarded in fiscal year 2009, with construction expected to start in fiscal year 2009.

Additional information on the Division's capital assets can be found in Note 7 to the attached financial statements.

Long-Term Debt

As of June 30, 2010, \$366 million in Highway Revenue Bonds were outstanding, compared to \$387 million as of June 30, 2009.

See Note 10 for additional information on Highway Revenue Bonds.

As of June 30, 2010, \$35 million in State of Hawaii General Obligation Bonds were outstanding, compared to \$41 million as of June 30, 2009. These bonds are considered general obligations of the State, and not the Division. Accordingly, no amounts are recorded by the Division for these liabilities. The Division makes debt service payments to repay principal and interest on these amounts. The payments for the fiscal year ended June 30, 2010 amounted to \$8 million, and the amount was recorded as an other financing use and transfer out in the financial statements.

See Note 11 for further information on general obligation bonds.

The Division's revenue bond rating by Moody's Investors Service, Inc., Standard & Poor's Corporation, and Fitch IBCA, Inc. are "Aa3," "AA+," and "AA-," respectively.

**State of Hawaii,
Department of Transportation – Highways Division**

Management's Discussion and Analysis – Unaudited
As of and for the Year Ended June 30, 2010

Generally, a rating agency bases its rating on the information and materials furnished to it and on investigations, studies, and assumptions of its own. There is no assurance that such ratings will continue for any given period of time or that such ratings will not be revised downward, suspended, or withdrawn entirely by the rating agencies if, in the judgment of such rating agencies, circumstances so warrant. The State undertakes no responsibility to oppose any such revision, suspension, or withdrawal.

Additional information on the Division's long-term liabilities can be found in Note 9 to the attached financial statements.

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the Division's finances for all interested parties. Questions concerning any of the information provided in this report or requests for additional information should be addressed to Gerald Dang, Administrative Services Officer, State of Hawaii, Department of Transportation, Highways Division, 869 Punchbowl Street, Honolulu, Hawaii, 96813.

State of Hawaii, Department of Transportation, Highways Division

Statement of Net Assets

June 30, 2010

<u>Assets</u>	<u>Governmental Activities</u>
Cash	\$ 242,787,329
Receivables, net of allowance for doubtful accounts:	
Due from U.S. Government	21,938,679
Due from City and Counties	5,571,892
Due from State of Hawaii	3,776,116
Other receivables	2,013,537
Prepaid Expenses	511,700
Restricted Cash:	
Revenue bond debt service	25,912,755
Security deposits	7,330,265
Bond Issuance Costs, net of accumulated amortization of \$2,034,967	1,502,603
Capital Assets, net of accumulated depreciation	5,263,440,778
Total assets	<u><u>\$ 5,574,785,654</u></u>

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Statement of Net Assets

June 30, 2010

<u>Liabilities and Net Assets</u>		<u>Governmental Activities</u>
Accounts Payable	\$	13,772,297
Accrued Payroll		3,433,361
Contracts Payable:		
Current portion		26,001,078
Retained percentage		9,493,175
Payable from Restricted Assets:		
Revenue bonds payable - due within one year		16,935,000
Interest payable		8,977,755
Security deposits		7,330,265
Other Liabilities		15,300
Long Term Liabilities:		
Due within one year:		
Workers' compensation payable		686,520
Accrued vacation payable		3,114,572
Revenue bonds payable		4,000,000
Due after one year:		
Workers' compensation payable		3,213,662
Accrued vacation payable		7,544,211
Revenue bonds payable		345,322,636
Total liabilities		<u>449,839,832</u>
Net Assets:		
Invested in capital assets, net of related debt		4,907,506,483
Restricted for current portion of revenue bonds		33,243,020
Unrestricted		<u>184,196,319</u>
Total net assets		<u>5,124,945,822</u>
Total liabilities and net assets		<u><u>\$ 5,574,785,654</u></u>

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Statement of Activities

For the Fiscal Year Ended June 30, 2010

	Governmental Activities
Operations and Maintenance:	
Oahu highways and services	\$ 68,520,415
Hawaii highways and services	24,460,650
Maui highways and services	22,225,589
Kauai highways and services	17,899,535
Molokai highways and services	1,210,128
Lanai highways and services	322,061
Pass through for County highways and services	19,198,959
Administration of Highways Division	51,756,737
Surcharge on Gross Receipts	6,980,997
Motor Vehicle Safety Office	9,070,726
Capital Projects	1,049,435
Depreciation Expense	220,434,833
Interest Expense	16,932,672
	<hr/>
Total expenses	460,062,737
	<hr/>
Program Revenues:	
Charges for services:	
Vehicle registration fees	20,611,355
Other fees and permits	2,525,743
Penalties and fines	1,705,935
Rentals	1,186,398
Operating grants and contributions	54,350,963
Capital grants and contributions	125,689,095
	<hr/>
Total program revenues	206,069,489
	<hr/>
General Revenues:	
Taxes:	
State fuel taxes	81,027,388
Rental motor and tour vehicle surcharge taxes	40,400,517
Vehicle weight taxes and penalties	33,102,395
Investment income	19,893,227
Non-imposed fringe benefits	834,261
	<hr/>
Total general revenues	175,257,788
	<hr/>
Deficiency of revenues under expenditures	(78,735,460)
	<hr/>
Transfers	(8,046,020)
	<hr/>
Change in net assets	(86,781,480)
	<hr/>
Net Assets:	
Beginning of year	5,211,727,302
	<hr/>
End of year	\$ 5,124,945,822
	<hr/> <hr/>

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Balance Sheet – Governmental Funds

June 30, 2010

<u>Assets</u>	<u>State Highway Fund</u>	<u>Debt Service Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>
Cash	\$ 111,721,233	\$ -	\$ 131,066,096	\$ 242,787,329
Receivables, net of allowance for doubtful accounts:				
Due from Capital Projects Fund	38,273,174	-	-	38,273,174
Due from U.S. Government	6,941,215	-	14,997,464	21,938,679
Due from City and Counties	5,571,892	-	-	5,571,892
Due from State of Hawaii	3,776,116	-	-	3,776,116
Other receivables	471,076	-	-	471,076
Prepaid Expenses	251,561	-	260,139	511,700
Restricted Cash:				
Revenue bond debt service	-	25,912,755	-	25,912,755
Security deposits	7,330,265	-	-	7,330,265
Total assets	<u>\$ 174,336,532</u>	<u>\$ 25,912,755</u>	<u>\$ 146,323,699</u>	<u>\$ 346,572,986</u>

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Balance Sheet – Governmental Funds

June 30, 2010

<u>Liabilities and Fund Balances</u>	<u>State Highway Fund</u>	<u>Debt Service Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>
Accounts Payable	\$ 12,148,337	\$ -	\$ 1,623,960	\$ 13,772,297
Accrued Payroll	3,433,361	-	-	3,433,361
Contracts Payable:				
Current portion	6,325,692	-	19,675,386	26,001,078
Retainage payable	4,626,854	-	4,866,321	9,493,175
Payable from Restricted Assets:				
Matured bonds and interest payable	-	25,912,755	-	25,912,755
Security deposits	7,330,265	-	-	7,330,265
Due to State Highway Fund	-	-	38,273,174	38,273,174
Other Liabilities	15,300	-	-	15,300
Total liabilities	<u>33,879,809</u>	<u>25,912,755</u>	<u>64,438,841</u>	<u>124,231,405</u>
Fund Balances:				
Reserved for:				
Encumbrances	108,040,341	-	279,766,958	387,807,299
Prepaid expenses	251,561	-	260,139	511,700
Unreserved	32,164,821	-	(198,142,239)	(165,977,418)
Total fund balances	<u>140,456,723</u>	<u>-</u>	<u>81,884,858</u>	<u>222,341,581</u>
Total liabilities and fund balances	<u>\$ 174,336,532</u>	<u>\$ 25,912,755</u>	<u>\$ 146,323,699</u>	<u>\$ 346,572,986</u>

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets
June 30, 2010

Total Fund Balances - Governmental Funds \$ 222,341,581

Amounts reported for governmental activities in the statement
of net assets are different because:

Capital assets used in governmental activities are not financial
resources and therefore are not reported in the Governmental
Funds financial statements. These assets consist of:

Governmental capital assets	9,630,035,061	
Less accumulated depreciation	<u>(4,366,594,283)</u>	
		5,263,440,778

Bonds issuance costs are recorded as expenditures in governmental
funds financial statements when incurred. However, in
Government-Wide financial statements, such amounts are
recorded as a deferred charge and amortized over the life of the
related bonds

1,502,603

Long-term liabilities are not due and payable in the current period
and therefore are not reported in the Governmental Funds
financial statements:

Accrued vacation payable	(10,658,783)	
Accrued workers' compensation payable	(3,900,182)	
Revenue bonds payable	<u>(349,322,636)</u>	
		(363,881,601)

Long term receivables are not due and receivable in the current
period and therefore are not reported in the Governmental
Funds financial statements

1,542,461

Net Assets of Governmental Activities	<u><u>\$5,124,945,822</u></u>
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See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds

For the Fiscal Year Ended June 30, 2010

	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total
Expenditures:				
Operations and maintenance:				
Oahu highways and services	\$ 70,425,424	\$ -	\$ -	\$ 70,425,424
Hawaii highways and services	24,848,621	-	-	24,848,621
Maui highways and services	22,509,872	-	-	22,509,872
Kauai highways and services	18,361,169	-	-	18,361,169
Molokai highways and services	1,210,128	-	-	1,210,128
Lanai highways and services	322,061	-	-	322,061
Pass through for County highways and services	19,198,959	-	-	19,198,959
Administration of Highways Division	55,263,022	-	-	55,263,022
Surcharge on gross receipts	6,980,997	-	-	6,980,997
Motor Vehicle Safety Office	9,070,726	-	-	9,070,726
Capital projects	-	-	190,650,196	190,650,196
Debt service:				
Principal payments	-	20,535,000	-	20,535,000
Interest expense	-	18,027,510	-	18,027,510
Total expenditures	228,190,979	38,562,510	190,650,196	457,403,685
Program Revenues:				
Charges for services:				
Vehicle registration fees	20,611,355	-	-	20,611,355
Other fees and permits	2,525,743	-	-	2,525,743
Penalties and fines	1,705,935	-	-	1,705,935
Rentals	1,186,398	-	-	1,186,398
Operating grants and contributions	54,865,117	-	-	54,865,117
Capital grants and contributions	-	-	125,689,095	125,689,095
Total program revenues	80,894,548	-	125,689,095	206,583,643

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds

For the Fiscal Year Ended June 30, 2010

	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total
General Revenues:				
Taxes:				
Fuel taxes	\$ 81,027,388	\$ -	\$ -	\$ 81,027,388
Rental motor and tour vehicle surcharge taxes	40,400,517	-	-	40,400,517
Vehicle weights taxes	33,102,395	-	-	33,102,395
Investment income	19,893,227	-	-	19,893,227
Non-imposed fringe benefits	834,261	-	-	834,261
Total general revenues	175,257,788	-	-	175,257,788
Excess (deficiency) of revenues over (under) expenditures	27,961,357	(38,562,510)	(64,961,101)	(75,562,254)
Other Financing Sources (Uses):				
Transfers in	-	38,562,510	7,069,859	45,632,369
Transfers out	(53,678,389)	-	-	(53,678,389)
Total other financing (uses) sources	(53,678,389)	38,562,510	7,069,859	(8,046,020)
Deficiency of revenues and other financing sources under expenditures and other financing uses	(25,717,032)	-	(57,891,242)	(83,608,274)
Fund Balances:				
Beginning of year	166,173,755	-	139,776,100	305,949,855
End of year	\$ 140,456,723	\$ -	\$ 81,884,858	\$ 222,341,581

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Reconciliation of the Statement of Revenues, Expenditures and
Changes in Fund Balances to the Statement of Activities
For the Fiscal Year Ended June 30, 2010

Net Change in Fund Balances - Total Governmental Funds	\$	(83,608,274)
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Amounts reported for governmental activities in the statement of
activities are different because:

Governmental funds report capital outlays as expenditures.

However, in the statement of activities, the cost of those assets
is allocated over their estimated useful lives and reported as
depreciation expense:

Expenditures for capital assets	195,176,856	
Less current fiscal year depreciation	<u>(220,434,833)</u>	
		(25,257,977)

Repayment of bond principal is reported as expenditures in the
Governmental Funds financial statements, but the repayment
reduces long-term liabilities in the Government-Wide financial
statements:

Bond principal repayment	19,750,000	
Change in debt service liability recognized in debt service fund	<u>785,000</u>	
		20,535,000

Bond issue costs, original issue premium, and deferred amount on
refunding are reported as incurred in governmental funds as they
require the use of current financial resources. However, in the
Government-Wide financial statements, these expenses are
deferred and amortized to expense over the remaining life of the
related bond:

Amortization of bond premiums	2,065,118	
Amortization of deferred amount on refunding	(745,603)	
Amortization of deferred bond issuance costs	<u>(224,677)</u>	
		1,094,838

Other revenues and expenditures in the Government-Wide financial
statements do not provide or use current financial resources and
therefore are not reported as revenues and expenditures in
governmental funds financial statements

		<u>454,933</u>
Change in Net Assets - Governmental Activities	\$	<u><u>(86,781,480)</u></u>

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

State Highway Fund

Statement of Revenues and Expenditures - Budget and Actual (Non-GAAP Budgetary Basis)

For the Fiscal Year Ended June 30, 2010

	Original	Final	Actual on Budgetary Basis	Variance Over (Under)
Revenues:				
Fuel taxes	\$ 86,797,575	\$ 86,797,575	\$ 81,027,388	\$ (5,770,187)
Vehicle weights taxes	33,824,832	33,824,832	32,937,315	(887,517)
Rental motor and tour vehicle surcharge taxes	39,746,781	39,746,781	40,400,517	653,736
Vehicle registration fees	21,047,658	21,047,658	20,576,745	(470,913)
Investment income	12,000,000	12,000,000	4,893,054	(7,106,946)
Other fees and penalties	4,311,693	4,311,693	5,017,468	705,775
	<u>197,728,539</u>	<u>197,728,539</u>	<u>184,852,487</u>	<u>(12,876,052)</u>
Expenditures:				
Operations and maintenance:				
Oahu highways and services	86,095,054	78,299,513	88,848,040	10,548,527
Hawaii highways and services	23,068,777	25,005,486	19,500,582	(5,504,904)
Maui highways and services	18,931,493	19,116,493	16,910,544	(2,205,949)
Kauai highways and services	13,541,296	13,531,296	12,477,163	(1,054,133)
Molokai highways and services	4,002,919	3,977,919	3,515,098	(462,821)
Lanai highways and services	830,403	805,403	779,407	(25,996)
Administration of Highways				
Division including debt service	60,095,125	59,945,125	61,817,163	1,872,038
Surcharge on gross receipts	8,115,699	8,115,699	6,015,432	(2,100,267)
Motor Vehicle Safety Office	5,864,339	5,839,339	8,099,374	2,260,035
	<u>220,545,105</u>	<u>214,636,273</u>	<u>217,962,803</u>	<u>3,326,530</u>
Deficiency of revenues under expenditures and other uses	<u>\$ (22,816,566)</u>	<u>\$ (16,907,734)</u>	<u>\$ (33,110,316)</u>	<u>\$ (16,202,582)</u>

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Agency Fund

Statement of Asset and Liability

June 30, 2010

	<u>Asset</u>	<u>Agency Fund</u>
Cash		\$ 7,308,603
Total asset		<u>\$ 7,308,603</u>
	<u>Liability</u>	
Due to Others		\$ 7,308,603
Total liability		<u>\$ 7,308,603</u>

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation - Highways Division

Notes to the Basic Financial Statements
June 30, 2010

1. Financial Reporting Entity

Act 1, Session Laws of Hawaii (SLH), Second Special Session 1959, the Hawaii State Government Reorganization Act of 1959 (Act), established the Department of Transportation (Department) whose function is to establish, maintain, and operate transportation facilities of the State of Hawaii (State), including highways, airports, harbors and such other transportation facilities and activities as may be authorized by law. The Department's activities are carried out through three primary operating divisions: Airports, Harbors, and Highways (Division). Through the Division, the Department has general supervision of the management and maintenance of the State Highways System and the location, design, and construction of new highways and facilities. The Division provides supervision to assure completion of State highway contracts in accordance with plans and specifications.

Taxes, fees and charges authorized and collected relating to the operation and use of motor vehicles on public highways of the State are deposited into the State Highway Fund, and expenditures for purposes of the Act are made from the State Highway Fund.

The State Highway Fund also includes the Motor Vehicle Safety Office (MVSO). The MVSO was originally established as the Highway Safety Coordinator's Office to implement the 1967 Hawaii Highway Safety Act. It was reorganized by the 1977 State Legislature to encompass the additional duty of the safety of operations of heavy motor vehicles. The MVSO is assigned as a staff office under the Division.

2. Significant Accounting Policies

a. Basis of Presentation

The Division's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America.

b. Governmental Funds Financial Statements

The accounts of the Division are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures. Government resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

2. Significant Accounting Policies (continued)

b. Governmental Funds Financial Statements (continued)

activities are controlled. For financial reporting purposes, the Division includes all funds that are controlled by or dependent on the Division's administrative head. Control by or dependence on the Division was determined on the basis of statutory authority and monies flowing through the Division to each fund or account.

Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. The Division considers all revenues reported in the governmental funds to be available if the revenues are collected within 90 days after year-end. Revenues susceptible to accrual include federal grants and tax and fee revenues. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures when payment is due. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of general long-term debt are reported as other financing sources.

A description of the funds administered by the Highways Division and included in the governmental funds financial statements follows:

State Highway Fund – The State Highway Fund generally accounts for revenues and expenditures for highway operations, maintenance and administration.

The State Highway Fund is a special revenue fund of the State established by Section 248-8, Hawaii Revised Statutes (HRS). All fuel taxes collected under Section 243-4, HRS except county fuel taxes, aviation fuel taxes, and taxes on fuel sold for use by small boats are deposited in the State Highway Fund.

Section 248-9, HRS provides that monies in the State Highway Fund shall be expendable by the Department of Transportation for the design, construction, reconstruction, repair and maintenance, and for acquisition of rights-of-way for public highways included in the State Highway Fund established under Section 264-41, HRS.

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

2. Significant Accounting Policies (continued)

b. Governmental Funds Financial Statements (continued)

Debt Service Fund – The Debt Service Fund accounts for the Division’s financial resources obtained and used for the payment of principal and interest on State of Hawaii Highway Revenue Bonds.

Capital Projects Fund – The Capital Projects Fund accounts for the Division’s construction projects and the related sources of financing.

The accompanying financial statements include highway projects authorized by legislative acts through June 30, 2010.

c. Government-Wide Financial Statements

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. The effect of interfund activity has been removed from these financial statements.

Statement of Net Assets – The statement of net assets includes all capital assets and long-term liabilities that are excluded from the Governmental Funds financial statements. The net assets are reported in three categories: invested in capital assets, net of related debt; restricted for current portion of revenue bonds; and unrestricted.

Statement of Activities – The statement of activities reports expenses and revenues in a format that focuses on the cost of the Division’s programs. Revenues are classified as either program revenues or general revenues. Program revenues include charges paid by users, as well as capital or operating grants. Revenues that are not classified as program revenues, including all taxes are presented as general revenues.

State of Hawaii, Department of Transportation - Highways Division

Notes to the Basic Financial Statements
June 30, 2010

2. Significant Accounting Policies (continued)

d. Fiduciary Fund Financial Statements

The agency fund is used to account for assets held by the Division on behalf of other departments of the State. Cash reported in the agency fund statement of assets and liabilities includes cash in the State Treasury, including deposits received and held for others in the amount of \$7,308,603 at June 30, 2010.

e. Cash and Restricted Cash

The State has an established policy whereby all unrestricted and certain restricted cash is invested in the State's investment pool. Section 36-21, HRS, authorizes the State to invest in obligations of the State, the U.S. Treasury, agencies and instrumentalities, certificates of deposit, and bank repurchase agreements.

Information relating to individual bank balances, insurance, and collateral of cash deposits is not available since such information is determined on a statewide basis and not for individual departments or divisions. A portion of the bank balances is covered by federal deposit insurance or by collateral held by the State Treasury, or by the State's fiscal agents in the name of the State. Other bank balances are held by fiscal agents in the State's name for the purpose of satisfying outstanding bond obligations. Accordingly, these deposits are exposed to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the State's deposits may not be returned to it. For demand or checking accounts and certificates of deposit, the State requires that the depository banks pledge collateral based on the daily available bank balance to limit its exposure to custodial credit risk. The use of daily available bank balances to determine collateral requirements results in the available balances being under-collateralized at various times during the fiscal year. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State. The State also requires that no more than 60% of the State's total funds available for deposit and on deposit in the State Treasury may be deposited in any one financial institution.

At June 30, 2010, a portion of the State Treasury Investment Pool was invested in auction rate securities, in which the State would determine the fair value related to these auction rate securities and allocate any change in values to the respective departments or agencies. The change in fair value allocated to the Division amounted to approximately \$15.6 million, which is recorded in investment income in the accompanying financial statements.

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

2. Significant Accounting Policies (continued)

e. Cash and Restricted Cash (continued)

Restricted cash consists of monies and other resources, the use of which is legally restricted. Restricted cash accounts for the principal and interest amounts accumulated to make debt service payments on the Division's revenue bonds and also include security deposits collected from third parties.

f. Receivables

Receivables are reported at their gross value when earned and are reduced by the estimated portion that is expected to be uncollectible. The allowance for uncollectible accounts is based on collection history and current information regarding the credit worthiness of the tenants and others doing business with the Division. When continued collection activity results in receipt of amounts previously written off, revenue is recognized for the amount collected. At June 30, 2010, the allowance for uncollectible receivables was approximately \$353,000.

g. Capital Assets

Capital assets, which include land and land improvements, buildings and improvements, vehicles and equipment, infrastructure (i.e., roads, bridges, tunnels), and construction in progress, are reported in the government-wide statement of net assets. Such assets are recorded at cost or at estimated fair market value at the date of donation. Capital outlays are recorded as expenditures of the State Highway Fund or Capital Projects Fund in the governmental funds and as assets in the government-wide statement of net assets to the extent the capitalization threshold is met. Capital assets are depreciated by the straight-line method over their useful lives estimated by management as follows:

<u>Class of Assets</u>	<u>Estimated Useful Life</u>	<u>Capitalization Threshold</u>
Land improvements	15 years	\$ 100,000
Buildings	30 years	\$ 100,000
Building improvements	30 years	\$ 100,000
Vehicles and equipment	5 to 7 years	\$ 5,000
Infrastructure	13 to 75 years	\$ 100,000

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

2. Significant Accounting Policies (continued)

g. Capital Assets (continued)

Disposals of assets are recorded by removing the costs and related accumulated depreciation from the accounts with the resulting gain or loss recorded in operations.

Repairs and maintenance, and minor replacements, renewals, and betterments are charged against operations. Major replacements, renewals, and betterments are capitalized.

h. Accrued Vacation and Compensatory Pay

The Division accrues all vacation and compensatory pay at current salary rates, including additional amounts for certain salary-related expenses associated with the payment of compensated absences, in accordance with GASB Statement No. 16, *Accounting for Compensated Absences*. Vacation is earned at the rate of 168 or 96 hours per calendar year, depending on the employee's date of hire. Accumulation of such vacation is limited to 720 hours at calendar year-end and is convertible to pay upon termination of employment.

i. Long-Term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities. Bond premiums, issuance costs, and deferred amounts on refunding are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium and deferred amounts on refunding. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the governmental funds financial statements, bond premiums and issuance costs are recognized as paid. The face amount of debt and any related premium are reported as other financing sources. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

2. Significant Accounting Policies (continued)

j. Encumbrances

The Division's accounting procedures provide for the recording of commitments as encumbrances at the time contracts are awarded and executed. Purchase orders issued for materials, supplies, and services chargeable to annual appropriations for operating costs, which are outstanding at the end of the year, are also encumbered. Encumbrances are recorded as a reservation of fund balance in the governmental funds balance sheet. The related expenditures are reported in the period in which the liability is incurred. Encumbrances are not recognized in the government-wide statement of net assets.

k. Employees' Retirement System

The Division's contributions to the Employee's Retirement System of the State of Hawaii (ERS) are based on the current contribution rate determined by the State Department of Budget and Finance. The Division's policy is to fund its required contribution each pay period.

l. Risk Management

The Division is exposed to various risks of loss from torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. The State is self-insured for workers' compensation as discussed in Note 16. Liabilities related to these losses are reported when it is probable that the losses have occurred and the amount of those losses can be reasonably estimated.

m. Intrafund and Interfund Transactions

Significant transfers of financial resources between activities included within the same fund are offset within that fund. Transfers of revenues from funds authorized to receive them to funds authorized to expend them have been recorded as operating transfers in the financial statements.

n. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

2. Significant Accounting Policies (continued)

o. Recently Adopted Accounting Pronouncements

In 2009, the Division adopted GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The Statement incorporates the hierarchy of GAAP for state and local governments into GASB's authoritative literature. The sources of accounting principles that are generally accepted are categorized in descending order of authority as follows: (1) officially established accounting principles – GASB Statements and Interpretations, (2) GASB Technical Bulletins, (3) AICPA Practice Bulletins, and (4) Implementations Guides. This Statement was effective upon its issuance. The adoption of GASB Statement No. 55 did not have an impact on the Division's financial position or results of operations.

In 2009, the Division adopted GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. This Statement incorporates into GASB the following three accounting and reporting guidelines currently existing in the American Institute of Certified Public Accountants' Statement on Auditing Standards – related party transactions, going concern considerations and subsequent events. The adoption of GASB Statement No. 56 did not have an impact on the Division's financial position or results of operations.

In 2010, the Division adopted GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This Statement incorporates into GASB certain accounting and reporting guidelines currently existing in the Financial Accounting Standards Board's Statements and Interpretations, the Accounting Principles Board Opinions and the American Institute of Certified Public Accountants' Committee on Accounting Procedure's Accounting Research Bulletins. The adoption of GASB Statement No. 62 did not have an impact on the Division's financial position or results of operations.

p. Recently Issued Accounting Pronouncements

In 2009, the GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. This Statement establishes standards of accounting and financial reporting standards for all governments that report governmental funds. It establishes criteria for classifying fund balances into specially defined classifications and clarifies definitions for governmental fund types. This Statement is effective for financial statement periods beginning after June 15, 2010. Management is currently assessing the impact of GASB Statement No. 54

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

2. Significant Accounting Policies (continued)

p. Recently Issued Accounting Pronouncements (continued)

on its financial position and results of operations and has not determined if the adoption will have a material effect on its financial statements.

In 2010, the GASB issued Statement No. 59, *Financial Instrument Omnibus*. This Statement provides accounting and financial reporting guidance related to certain financial instruments and external investment pools by providing more complete information, improving consistency of measurements, and providing clarifications of existing standards. This Statement is effective for financial statement periods beginning after June 15, 2010. Management is currently assessing the impact of GASB Statement No. 59 on its financial position and results of operations and has not determined if the adoption will have a material effect on its financial statements.

q. Reclassifications

Certain amounts have been reclassified for 2009 to conform to the classifications adopted in 2010. Such reclassifications had no effect on the previously reported statement of activities.

3. Budget and Budgetary Accounting

a. State Highway Fund

In the Governmental Funds State Highway Fund Statement of Revenues and Expenditures - Budget and Actual (non-GAAP budgetary basis), amounts reflected as original and amended budgeted revenues are the official estimates as compiled by the Division's management and the State Department of Budget and Finance at the time of budget consideration and adoption by the State Legislature. Revenue received from federal grants-in-aid is not included in the State Highway Fund Statement of Revenues and Expenditures - Budget and Actual (non-GAAP budgetary basis) since such grants are normally reimbursements of costs incurred on approved projects.

In the case of expenditures, the original and amended budgeted amounts reflected on the Governmental Fund State Highway Fund Statement of Revenues and Expenditures - Budget and Actual (non-GAAP budgetary basis) are derived from: the Supplemental Appropriations Act of 2006 (Act 160, SLH 2006) authorizations for expenditures for operating purposes for the Division of \$208,796,934 and the MVSO \$5,839,339.

State of Hawaii, Department of Transportation - Highways Division

Notes to the Basic Financial Statements
June 30, 2010

3. Budget and Budgetary Accounting (continued)

a. State Highway Fund (continued)

Allotments are made and expenditures are controlled at the program level reflected in the Governmental Funds State Highway Fund Statement of Revenues and Expenditures - Budget and Actual (non-GAAP budgetary basis). State Highway Fund allotments lapse at year-end.

The reconciliation of the budgetary actual deficiency of revenues over expenditures as shown on the Governmental Fund statement of revenues and expenditures - budget and actual - State Highway Fund (non-GAAP budgetary basis) to the Governmental Funds statement of revenues, expenditures, and changes in fund balances -State Highway Fund is as follows:

Deficiency of revenue over expenditures, non-GAAP budgetary basis	\$ (33,110,316)
Federal grants-in-aid	54,865,117
Operating transfers out of the Division for debt service	8,046,020
Pass through expenditures for county projects	(19,198,959)
Net decrease in the fair value of State Treasury Investment Pool	15,647,680
Other adjustments to modified accrual basis of accounting	<u>1,711,815</u>
Excess of revenues over expenditures, GAAP basis before transfers	<u><u>\$ 27,961,357</u></u>

b. Capital Projects Fund

Excess Capital Projects Fund allotments lapse after completion of the project, which is generally two or three years subsequent to allotment. Funds allotted as part of a qualified federal award program do not lapse.

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

4. Tax and Fee Revenues

a. State Fuel Tax

The primary source of revenue for the State Highway Fund is the state tax on liquid (motor vehicle) fuel. For fiscal year 2010, the tax imposed on each gallon of fuel was as follows:

Gasoline	17 cents
Diesel Fuel:	
Non-highway use	2 cents
Highway use	17 cents
Liquefied Petroleum Gas	5.2 cents

b. Vehicle Weight Tax and Penalties

The vehicle weight tax was 0.75 to 1.25 cents per pound of net vehicle weight, to a maximum of \$150 per vehicle.

c. Rental Motor and Tour Vehicle Surcharge Tax

The rental motor vehicle surcharge tax was \$3 a day or any portion of a day that a rental motor vehicle is rented or leased. The tour vehicle surcharge tax was \$65 a month for tour vehicles categorized by the Public Utilities Commission as an over 25-passenger carrier vehicle and \$15 a month for tour vehicles categorized as an 8 to 25 passenger carrier vehicle.

d. Vehicle Registration and Motor Carrier Safety Inspection Fee

The vehicle registration fee was \$25 per vehicle, of which \$5 is earmarked for deposit into the Emergency Medical Services (EMS) special fund. During the year ended June 30, 2010 the Division collected approximately \$5,145,000 on behalf of the EMS special fund. All amounts were disbursed to the EMS special fund. Accordingly, no amounts are reported in the financial statements at June 30, 2010. The motor carrier safety inspection fee was \$1.50 per vehicle every six months.

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

5. Federal Grants-In-Aid

The Division has projects in progress in which part of the funding is being provided by the Federal Highway Administration (FHWA) through grants-in-aid. Such projects are generally accounted for in the Capital Projects and State Highway Funds. At June 30, 2010, receivables totaling \$21,938,679 from the U.S. Government are comprised of billed costs, pending reimbursement, as well as unbilled costs, which are eligible for reimbursement.

In addition, the MVSO has projects in progress in which part of the funding is being provided through federal grants-in-aid. The grants contain various compliance requirements, which must be met by the MVSO, including a matching of the grant amounts with state and local highway safety expenditures as defined in a formula. MVSO's matching requirement is met through the expenditures of the Division of Driver Education, The Judiciary, State of Hawaii. Cost reimbursement by the FHWA and National Highway Traffic Safety Administration (NHTSA) are subject to final audit by federal agencies. In addition, FHWA and NHTSA reserve the right to examine the Division for economy, efficiency, and program results. The Division's management believes that any federal aid received as of June 30, 2010 that might be required to be repaid to the FHWA or NHTSA based on federal audits would not be material to the financial position of the various funds of the Division at June 30, 2010, or the results of operations of such funds for the year then ended.

6. Non-Imposed Fringe Benefits

Payroll fringe benefit costs of employees of the Division are assumed by the State and are not charged to the Division's operating funds. These costs totaling \$834,261 for fiscal year 2010 have been reported as revenues and expenditures in the State Highway Fund.

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

7. Capital Assets

Changes in capital assets during the year ended June 30, 2010 was as follows:

	Balance July 1, 2009	Additions	Deductions	Transfers	Balance June 30, 2010
Nondepreciable assets:					
Land	\$ 433,091,792	\$ 2,298,175	\$ -	\$ -	\$ 435,389,967
Construction in progress	357,331,152	187,302,586	-	(284,575,185)	260,058,553
Software under development	3,003,812	2,537,198	-	-	5,541,010
Infrastructure	763,719,476	-	-	39,247,962	802,967,438
Total	1,557,146,232	192,137,959	-	(245,327,223)	1,503,956,968
Depreciable assets:					
Land improvements	2,215,473	-	-	-	2,215,473
Buildings and improvements	28,270,355	-	-	271,439	28,541,794
Vehicles and equipment	58,631,314	3,038,897	(1,401,646)	-	60,268,565
Infrastructure	7,790,250,455	-	(253,978)	245,055,784	8,035,052,261
Total	7,879,367,597	3,038,897	(1,655,624)	245,327,223	8,126,078,093
Less accumulated depreciation	(4,147,815,074)	(220,434,833)	1,655,624	-	(4,366,594,283)
Depreciable assets, net	3,731,552,523	(217,395,936)	-	245,327,223	3,759,483,810
Capital assets, net	\$5,288,698,755	\$ (25,257,977)	\$ -	\$ -	\$5,263,440,778

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

8. Net Assets

At June 30, 2010 net assets consisted of the following:

Invested in Capital Assets, Net of Related Debt:

Net property, plant and equipment	\$ 5,263,440,778
Less: Revenue bonds payable	(366,257,636)
Add: Unspent debt proceeds	<u>10,323,341</u>
	4,907,506,483

Restricted for Debt Service and Capital Activity:

Restricted for capital projects	10,323,341
Restricted for debt service	25,912,755
Restricted for security deposits	7,330,265
Less: Unspent debt proceeds	<u>(10,323,341)</u>
	33,243,020

Unrestricted

	<u>184,196,319</u>
Total net assets	<u><u>\$ 5,124,945,822</u></u>

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

9. General Long-Term Liabilities

Changes in general long-term liabilities during the year ended June 30, 2010 were as follows:

	Balance July 1, 2009	Additions	Reductions	Balance June 30, 2010	Amount Due Within One Year
Accrued vacation payable	\$ 11,094,968	\$ 4,013,062	\$ (4,449,247)	\$ 10,658,783	\$ 3,114,572
Workers' compensation payable	4,433,084	153,618	(686,520)	3,900,182	686,520
Revenue bonds payable – unamortized premium	13,522,045	-	(2,065,118)	11,456,927	-
Revenue bonds payable – deferred loss of defeasance	(4,299,894)	-	745,603	(3,554,291)	-
Revenue bonds payable	378,105,000	-	(19,750,000)	358,355,000	20,935,000
Total governmental activities long-term liabilities	<u>\$ 402,855,203</u>	<u>\$ 4,166,680</u>	<u>\$ (26,205,282)</u>	<u>\$ 380,816,601</u>	<u>\$ 24,736,092</u>

10. Revenue Bonds

In 1993, the Director of the Department of Transportation issued the *Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Highway Revenue Bonds* (Certificate). Subsequent issues of revenue bonds were covered by supplemental certificates to the original 1993 Certificate.

These revenue bonds are payable solely from, and collateralized solely by, the revenues held in the State Highway Fund consisting primarily of highway fuel taxes, vehicle registration fees, vehicle weight taxes, rental motor vehicle and tour vehicle surcharge taxes, and interest earnings on monies previously credited to the State Highway Fund. The proceeds of the revenue bonds are used to finance certain highway capital improvement projects and other related projects for the State Highways System.

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

10. Revenue Bonds (continued)

On July 1, 1998, the Division issued \$94,920,000 in State of Hawaii Highway Revenue Bond, Series 1998 (1998 Bonds). The 1998 Bonds bear interest at rates ranging from 4.5% to 5.5% and mature in increasing annual installments through 2018. The 1998 Bonds maturing on and after July 1, 2009 through July 1, 2016 are subject to redemption at the option of the State on or after July 1, 2008 at prices ranging from 101% to 100% plus accrued interest.

On October 1, 2000, the Division issued \$50,000,000 in State of Hawaii Highway Revenue Bond, Series 2000 (2000 Bonds). The 2000 Bonds bear interest at rates ranging from 4.4% to 5.5% and mature in increasing annual installments through 2020. The 2000 Bonds maturing on and after July 1, 2011 through July 1, 2020 are subject to redemption at the option of the State after July 1, 2010 at a price of 100% plus accrued interest.

On October 3, 2001, the Division issued \$70,000,000 in State of Hawaii Highway Revenue Bond, Series 2001 (2001 Bonds). The 2001 Bonds bear interest at rates ranging from 3.8% to 5.4% and mature in increasing annual installments through 2022. The 2001 Bonds maturing on and after July 1, 2011 are subject to redemption at the option of the State at a redemption of 100% plus accrued interest. These bonds were issued at a premium of \$2,787,593, which will be amortized over the life of the bonds using the effective interest method.

On April 15, 2003, the Division issued \$44,940,000 in State of Hawaii Highway Revenue Bonds, Series 2003 (Refunding Series of 2003) with interest rates ranging from 2.00% to 5.25% to refund \$45,350,000 of its outstanding State of Hawaii Revenue Bonds, Series 1993 (1993 Bonds) with interest rates ranging from 2.6% to 5.0%. The net proceeds of \$46,749,377 (after payment of \$452,013 in underwriting fees, insurance, and other costs), along with an additional \$519,500 from the State Highways Fund were deposited in an irrevocable trust with an escrow agent to be used to purchase non-callable direct obligations of the United States, maturing in amounts and bearing interest at such rates sufficient to meet the debt service requirements of the 1993 Bonds. On July 1, 2003, the refunded bonds were redeemed at a price of 102%. As a result, the refunded portion of the 1993 Bonds is considered to be defeased and the liability for those bonds has been removed from the financial statements.

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

10. Revenue Bonds (continued)

The refunding resulted in a difference between the reacquisition price and the net carrying amount of the refunded debt of \$1,399,377. This difference, reported in the accompanying financial statements as a deduction from Highways revenue bonds, is being charged to interest expense over the next 21 years. The Division in effect reduced its aggregate debt service payments by approximately \$4,165,000 over the next 21 years and obtained an economic gain (difference between the present values of the old and new debt service payment) of approximately \$3,687,000.

On February 20, 2005, the Division issued \$60,000,000 in State of Hawaii Revenue Bonds Series A (2005A Bonds). The 2005A Bonds bear interest at rates ranging from 3.0% to 5.0% and mature in annual installments through 2025. The 2005A Bonds maturing on and after July 1, 2016 are subject to redemption at the option of the State at 100% plus accrued interest. These bonds were issued at a premium of \$3,155,926, which will be amortized over the life of the bonds using the effective interest method.

On February 20, 2005, the Division issued \$123,915,000 in State of Hawaii Revenue Bonds Series B (2005B Bonds) with interest rates ranging from 3.0% to 5.25% to refund \$128,705,000 of outstanding bonds (refunded bonds) with interest rates ranging from 4.95% to 5.6% comprised of the following:

Series	Interest Rate	Principal Refunded
1996	5.25% - 5.60%	\$ 26,135,000
1998	5.00% - 5.25%	30,275,000
2000	4.95% - 5.50%	31,340,000
2001	5.25% - 5.38%	40,955,000

The net proceeds of \$137,847,002 (after payment of \$1,581,758 in underwriting fees, insurance, and other costs), along with an additional \$1,401,015 from the Highways Revenue Fund were deposited in an irrevocable trust with an escrow agent to be used to purchase non-callable direct obligations of the United States, maturing in amounts and bearing interest at such rates sufficient to meet the debt service requirements of the refunded bonds. As a result, the refunded portion of the bonds is considered to be defeased and the liability for those portions of the bonds has been removed from the financial statements.

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

10. Revenue Bonds (continued)

The refunding resulted in a difference between the reacquisition price and the net carrying amount of the refunded debt of \$7,439,199. This difference, reported in the accompanying financial statements as a deduction from Highway revenue bonds, is being charged to interest expense over the next 17 years. The Division in effect reduced its aggregate debt service payments by approximately \$12,042,000 over the next 17 years and obtained an economic gain (difference between the present values of the old and new debt service payments) of approximately \$8,944,000.

At June 30, 2010, approximately \$72,295,000 of revenue bonds outstanding are considered defeased.

On December 17, 2008, the Division issued \$125,175,000 in State of Hawaii Revenue Bonds, Series 2008 (2008 Bonds). The 2008 Bonds bear interest at rates ranging from 4.0% to 6.00% and mature in annual installments through 2029. The 2008 Bonds maturing on and after January 1, 2020 are subject to redemption at the option of the State at 100% plus accrued interest. These bonds were issued at a premium of \$857,616, which will be amortized over the life of the bonds using the effective interest method.

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

10. Revenue Bonds (continued)

The following is a summary of revenue bonds issued and outstanding at June 30, 2010:

Series	Interest Rate	Final Maturity Date (July 1)	Original Amount of Issue	Outstanding Amount
1998	4.00% - 5.50%	2018	\$ 94,920,000	\$ 27,580,000
2000	4.40% - 5.50%	2020	50,000,000	2,335,000
2001	3.80% - 5.40%	2022	70,000,000	11,450,000
2003	2.00% - 5.25%	2013	44,940,000	20,115,000
2005	3.00% - 5.25%	2025	183,915,000	175,300,000
2008	4.00% - 6.00%	2029	125,175,000	121,575,000
			<u>\$ 568,950,000</u>	358,355,000
		Add: unamortized premium		11,456,927
		Less: deferred amount on refunding		(3,554,291)
		Less: current portion		<u>(20,935,000)</u>
		Noncurrent portion		<u>\$345,322,636</u>

During 2010, \$38,562,510 was transferred from the State Highway Fund to the Debt Service Fund for repayment of revenue bonds principal of \$3,600,000 and \$16,935,000 due on January 1, 2010 and July 1, 2010, respectively and interest of \$9,049,755 and \$8,977,755 due on January 1, 2010 and July 1, 2010, respectively.

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

10. Revenue Bonds (continued)

The approximate maturities in each of the next five years and thereafter are as follows:

<u>Years Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 20,935,000	\$ 17,615,498	\$ 38,550,498
2012	21,730,000	16,743,810	38,473,810
2013	22,630,000	15,778,485	38,408,485
2014	23,700,000	14,686,373	38,386,373
2015	25,065,000	13,519,791	38,584,791
2016-2020	130,505,000	47,433,744	177,938,744
2021-2025	72,955,000	21,384,406	94,339,406
2026-2029	40,835,000	5,572,313	46,407,313
Total	<u>\$ 358,355,000</u>	<u>\$ 152,734,420</u>	<u>\$ 511,089,420</u>

11. Operating Transfers

Operating transfers accounted for in the governmental funds statement of revenues, expenditures, and changes in fund balances as other financing sources and uses, and on the government-wide statement of activities as transfers, are summarized as follows:

<u>Description</u>	<u>State Highway Fund</u>	<u>Debt Service Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>	<u>Statement of Activities</u>
Funding of highway capital projects	\$ (7,069,859)	\$ -	\$ 7,069,859	\$ -	\$ -
Reimbursement to State for debt service on general obligation bonds	(8,046,020)	-	-	(8,046,020)	(8,046,020)
Funding of revenue bond debt service	(38,562,510)	38,562,510	-	-	-
	<u>\$ (53,678,389)</u>	<u>\$ 38,562,510</u>	<u>\$ 7,069,859</u>	<u>\$ (8,046,020)</u>	<u>\$ (8,046,020)</u>

a. Funding of Highway Capital Projects

Funding of highway capital projects by the State Highway Fund is recognized when received by the Capital Projects Fund.

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

11. Operating Transfers (continued)

b. Reimbursement to State for Debt Service

Allocated portions of the State's general obligation bonds have been designated by the Director of Finance, State of Hawaii, to be reimbursed from the State Highway Fund. These bonds are the obligations of the State and are not included in these financial statements. The amount of the Division's reimbursement to the State for debt service is primarily determined by the Director of Finance, State of Hawaii.

The annual amounts required to amortize the designated portions of general obligation bonds as of June 30, 2010 are as follows:

<u>Years Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 10,091,760	\$ 1,060,325	\$ 11,152,085
2012	7,517,802	648,874	8,166,676
2013	4,495,130	325,076	4,820,206
2014	3,785,344	223,132	4,008,476
2015	3,609,440	153,095	3,762,535
2016-2020	5,113,405	156,008	5,269,413
2021	2,895	134	3,029
Total	<u>\$ 34,615,776</u>	<u>\$ 2,566,644</u>	<u>\$ 37,182,420</u>

Debt service reimbursements are accounted for as expenditures of the Administration of Highway Division program on the Governmental Funds State Highway Fund Statement of Revenues and Expenditures - Budget and Actual (non-GAAP budgetary basis) and are accounted for as other financing transfers out of the State Highway Fund on the Governmental Funds statement of revenues, expenditures, and changes in fund balances. Reimbursement payments of \$8,046,020 consisted of \$6,720,598 for principal and \$1,325,421 for interest for the year ended June 30, 2010.

State of Hawaii, Department of Transportation - Highways Division

Notes to the Basic Financial Statements
June 30, 2010

12. Retirement Benefits

a. Employees' Retirement System (ERS)

All eligible employees of the State and counties are required by Chapter 88, HRS, to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer public employee retirement plan. The ERS is governed by a Board of Trustees. All contributions, benefits and eligibility requirements are established by HRS Chapter 88 and can be amended by legislative action. The ERS issues a comprehensive annual financial report that is available to the public. That report may be obtained by writing to the ERS at 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Prior to June 30, 1984, the plan was a contributory plan only. In 1984, legislation was enacted to add a new non-contributory plan for members of the ERS who are also covered under Social Security. Police officers, firefighters, judges, elected officials, and persons employed in positions not covered by Social Security are precluded from the non-contributory plan. The non-contributory plan provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory plan or to elect the new non-contributory plan and receive a refund of employee contributions. All benefits vest after five and ten year credited service under the contributory and non-contributory plans, respectively.

Both plan options provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date is based on the three highest paid years of service, excluding the vacation payment.

On July 1, 2006, a new hybrid contributory plan became effective pursuant to Act 179, SLH of 2004. Members in the hybrid plan are eligible for retirement at age 62 with 5 years of credited services or age 55 and 30 years of credit service. Members will receive a benefit multiplier of 2% for each year of credited service in the hybrid plan. The benefit payment options are similar to the current contributory plan. Almost 58,000 current members, all members of the noncontributory plan and certain members of the contributory plan are eligible to join the new hybrid plan. Most of the new employees hired from July 1, 2006 are required to join the new hybrid plan.

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

12. Retirement Benefits (continued)

a. Employees' Retirement System (ERS) (continued)

Most covered employees of the contributory option are required to contribute 7.8% of their salary. The funding method used to calculate the total employer contribution requirement is the Entry Age Normal Actuarial Cost Method. Effective July 1, 2005, employer contribution rates are a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liability.

The Division's contribution to the ERS for fiscal years 2010, 2009, and 2008 was approximately \$6,708,000, \$7,257,000, and \$6,301,000, respectively, and represented the required contributions for each year.

b. Post-Retirement Health Care and Life Insurance Benefits

Plan Description

The Division contributes to the Hawaii Employer-Union Health Benefits Trust Fund (EUTF), an agent multiple-employer defined benefit plan that replaced the Hawaii Public Employees Health Fund effective July 1, 2003, pursuant to Act 88, SLH of 2001. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The eligibility requirements for retiree health benefits are as follows:

For employees hired before July 1, 1996, the Division pays the entire base monthly contribution for employees retiring with 10 years or more of credited service, and 50% of the base monthly contribution for employees retiring with fewer than ten years of credited service. A retiree can elect a family plan to cover dependents.

For employees hired after June 30, 1996 but before July 1, 2001, and who retire with at less than 10 years of service, the Division makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the Division pays 50% of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the Division pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the Division pays 100% of the base monthly contribution. Retirees in this category can elect a family plan to cover dependents.

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

13. Retirement Benefits (continued)

b. Post-Retirement Health Care and Life Insurance Benefits (continued)

For employees hired on or after July 1, 2001, and who retire with less than 10 years of service, the Division makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the Division pays 50% of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the Division pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the Division pays 100% of the base monthly contribution. Only single plan coverage is provided for retirees in this category. Retirees can elect family coverage but must pay the difference.

State Policy

The actuarial valuation of the EUTF does not provide other postemployment benefits (OPEB) information by department or agency. Accordingly, the State's policy on the accounting and reporting for OPEB is to allocate a portion of the State's Annual Required Contribution (ARC), interest, and any adjustment to the ARC, to component units and proprietary funds that are reported separately in the State's Comprehensive Annual Financial Report (CAFR) or in stand alone departmental financial statements. The basis for the allocation is the proportionate share of contributions made by each component unit and proprietary fund for retiree health benefits.

Amount of Contributions Made

Contributions are financed on a pay-as-you-go basis and the Division's contributions for the years June 30, 2010, 2009, and 2008 were approximately \$2,936,000, \$4,286,000 and \$3,937,000, respectively.

The State's Comprehensive Annual Financial Report includes the required footnote disclosures and required supplementary information on the State's OPEB plans. The State's CAFR can be found at the Department of Accounting and General Services' website: <http://hawaii.gov/dags/rpts>.

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

12. Retirement Benefits (continued)

c. Deferred Compensation Plan

The State established a deferred compensation plan (plan) in accordance with Section 457 of the Internal Revenue Code, which enables State employees to defer a portion of their compensation. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All amounts of deferred compensation, as well as property and rights purchased with those amounts and income attributable to those amounts, are held in trust by third-party agents for the exclusive benefit of participants and their beneficiaries. The assets and liabilities of the deferred compensation plan are not reflected in the Division's financial statements.

13. Transactions With Other Government Agencies

The State assesses a surcharge of 5% for central service expenses on all receipts of the State Highway Fund, after deducting any amounts pledged, charged, or encumbered for the payment of bonds and interest during the year. The assessment amounted to approximately \$6,981,000 in fiscal year 2010.

The Division is also assessed a percentage of the cost of the general administration expenses of the Department. During fiscal year 2010, assessments net of amounts refunded amounted to approximately \$4,591,000 which is included in administration expense in the accompanying financial statements.

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

14. Operating Leases

a. Rental Expenditures

The Division leases office and baseyard space under various long-term operating lease agreements expiring at various dates through fiscal year 2019. Rental expenditures are recorded based on the terms of the lease agreements. Scheduled annual minimum rental payments through 2015 and in five-year increments thereafter are as follows:

Years Ending June 30,	
2011	\$ -
2012	957,000
2013	957,000
2014	957,000
2015	957,000
2016-2019	<u>3,827,000</u>
Total	<u>\$ 7,655,000</u>

The total rental expenditures during fiscal year 2010 for operating leases were approximately \$748,000.

b. Rental Revenue

The Division is a lessor of various properties under non-cancelable lease agreements that expire through fiscal year 2044. Scheduled annual minimum revenues through 2015 and in five-year increments thereafter are as follows:

Years Ending June 30,	
2011	\$ 350,000
2012	355,000
2013	360,000
2014	366,000
2015	371,000
2016-2020	1,891,000
2021-2025	1,817,000
2026-2030	988,000
2031-2035	401,000
2036-2040	377,000
2041-2044	<u>229,000</u>
Total	<u>\$ 7,505,000</u>

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

15. Commitments

a. Condemnation Proceedings

The Division occasionally finds it necessary to condemn property for construction of highways. These proceedings require the Division to compensate existing property owners for the fair market value of their real property. Prior to the determination of the fair market value, the Division is required to deposit funds in State courts for these proceedings. The amount of funds deposited in the State courts was approximately \$2,018,000 at June 30, 2010. Such funds deposited may not be sufficient to cover the full amount required for compensation purposes. Management, however, believes any additional compensation in excess of amounts deposited with State courts will not be material to the financial statements of the Division. The funds deposited in the State courts are reflected in capital projects expenditures in the governmental fund statement of revenue, expenditures, and changes in fund balances and in capital assets on the government-wide statement of net assets in the year in which the deposits were made.

b. Accumulated Sick Leave

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit. It may be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for sick pay is recorded in the Division's financial statements. However, a public employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credits in the ERS. Accumulated sick leave at June 30, 2010 aggregated approximately \$22,721,000

16. Risk Management

a. Property and Liability Insurance

The Division is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and workers' compensation. The State generally retains the first \$1 million per occurrence of property losses and the first \$4 million with respect to general liability claims. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is \$225 million for windstorm, boiler and machinery and \$50 million for terrorism. The annual aggregate limit for property loss is \$225 million for flood and earthquake. The limit per occurrence of general liability losses is \$15 million. For certain general liability claims, the

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

16. Risk Management (continued)

b. Property and Liability Insurance (continued)

annual aggregate limit is \$15 million. The State also has an insurance policy to cover crime risk with a deductible of \$500,000 per occurrence and a \$10 million annual aggregate limit.

c. Workers' Compensation

The State is self-insured for workers' compensation. Accordingly, the Division is liable for workers' compensation claims filed by its employees. Liabilities for workers' compensation claims are established if information indicates that it is probable that liabilities have been incurred and the amount of those claims can be reasonably estimated. The basis for estimating the liabilities for unpaid claims include the effects of specific incremental claim adjustment expenses, salvage and subrogation, and other allocated or unallocated claim adjustment expenses. These liabilities include an amount for claims that have been incurred but not reported. The workers' compensation reserve amounted to \$3,900,182 at June 30, 2010.

17. Contingent Liabilities and Other

The State is the defendant in lawsuits seeking damages allegedly related to State highways and highway construction contracts. While the ultimate liabilities, if any, in the disposition of these matters are presently difficult to estimate, it is management's belief that the outcomes are not likely to have a material adverse effect on the Division's financial position. In addition, the State has not determined whether the ultimate liabilities, if any, will be imposed on the State Highway Fund. Accordingly, no provision for any liabilities that might result from the lawsuits have been made in the accompanying financial statements.

The Division is subject to laws and regulations relating to the protection of the environment. The Division has been identified by the State Department of Health (DOH) as a potentially responsible party for petroleum contamination in the Honolulu Harbor/Iwilei area. Pursuant thereto, the Division entered into a voluntary agreement with the DOH and other third parties to share in the responsibility for the investigation and potential remediation of petroleum contamination in the Iwilei District.

**State of Hawaii,
Department of Transportation - Highways Division**

Notes to the Basic Financial Statements
June 30, 2010

17. Contingent Liabilities and Other (continued)

This group of potentially responsible parties known as the Iwilei District Participating Parties (IDPP) has conducted various investigations to determine potential contamination in the Iwilei area from 1997 to present, which investigations have determined the existence of petroleum contamination at various locations. Potential remedial alternatives are still being studied. At this stage, the project has not yet advanced to the stage where total costs to the IDPP can reasonably be estimated, due to : (1) the extent of environmental impact, (2) the undetermined allocation among the potentially responsible parties, (3) the ongoing review of reasonable remediation alternatives, and (4) continued discussion with the regulatory authorities. As a result, it is not possible to reasonably estimate the amount of the potential cost to the IDPP and allocable share of the Division, and if there would be a material impact to the Division's financial statements. Accordingly, no estimate of loss has been recorded in the accompanying financial statement.

18. Deficit Balance

At June 30, 2010, the Capital Projects Fund had an unreserved fund balance deficit of approximately \$198 million. The deficit balance resulted primarily from the excess funds reserved for all committed capital contracts at year end.

PROPOSED FORM OF OPINION OF BOND COUNSEL

[Closing Date]

State of Hawaii
Honolulu, Hawaii

Re: State of Hawaii Highway Revenue Bonds, Series 2011

Ladies and Gentlemen:

We have acted as bond counsel in connection with the issuance by the State of Hawaii (the "State") of \$117,365,000 State of Hawaii Highway Revenue Bonds, Series 2011 A and Series 2011 B (the "Series 2011 A Bonds" and "Series 2011 B Bonds," respectively, and together, the "Series 2011 Bonds"), issued under and pursuant to the Constitution and statutes of the State, including particularly Part III of Chapter 39, Hawaii Revised Statutes, as amended (the "Act") and under and pursuant to the Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Highway Revenue Bonds, dated as of August 1, 1993 (the "Master Certificate"), as heretofore amended and supplemented and as further amended and supplemented by the Ninth Supplemental Certificate of the Director of Transportation Authorizing State of Hawaii Highway Revenue Bonds, Series 2011, dated as of December 1, 2011 (the "Ninth Supplemental Certificate" and, together with the Master Certificate, the "Certificate"). Capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Certificate.

In our capacity as bond counsel, we have reviewed a certified copy of the record of proceedings relating to the issuance of the Series 2011 Bonds, including originals or copies certified or otherwise identified to our satisfaction as being true copies of the Certificate and the Tax Certificate executed and delivered by the State in connection with the issuance of the Series 2011 Bonds (the "Tax Certificate"), an opinion of the State Department of the Attorney General, certificates of the State, and such other documents, certificates, opinions and matters we have considered necessary or appropriate under the circumstances to render the opinions set forth herein. Our services as bond counsel were limited to such examination and to rendering the opinions set forth below. We have examined originals or copies, certified or otherwise identified to our satisfaction, of such other documents, legal opinions, instruments and records, and have made such investigation of law, as we have considered necessary or appropriate for the purpose of this opinion, and, with your permission, we have assumed, but have not independently verified, that the signatures on all documents, certificates and opinions that we have reviewed are genuine.

In our examination, with your permission, we have assumed, but have not independently verified, the legal capacity of all natural persons, the authenticity of all documents submitted to us as originals, the conformity to original documents of all documents submitted to us as certified or photostatic copies or by facsimile or other means of electronic transmission or which we obtained from sites on the internet, and the authenticity of the originals of such latter documents. As to facts and certain other matters and the consequences thereof relevant to the opinions expressed herein and the other statements made herein, with your permission, we have relied without independent investigation or verification upon, and assumed the accuracy and completeness of the factual matters represented, warranted or certified in the documents, certificates, letters (including opinion letters), and oral and written statements and representations of public officials, officers and other representatives of the State. Furthermore, with your permission, we have assumed compliance with all covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause the interest on the Series 2011 Bonds to be included in gross income for federal income tax purposes. We have also assumed, with your permission, the correctness of the conclusion contained in the opinion of the State Department of the Attorney General that the Series 2011 Bonds are validly binding obligations of the State Department of Transportation.

Based on the foregoing, and subject to the limitations and qualifications herein specified, as of the date

hereof, and under current law, we are of the opinion that, assuming continuing compliance by the State with certain covenants in the Certificate and the Tax Certificate and the requirements of the Internal Revenue Code of 1986, as amended (the "Code"), regarding the use, expenditure and investment of the proceeds of the Series 2011 Bonds and the timely payment of certain investment earnings to the United States, interest on the Series 2011 Bonds is not includable in gross income for federal income tax purposes. Failure to comply with such covenants and requirements may cause interest on the Series 2011 Bonds to be included in federal gross income retroactive to the date of issuance of the Series 2011 Bonds. Interest on the Series 2011 Bonds is not treated as an item of tax preference in calculating the federal alternative minimum taxable income of individuals or corporations. Interest on the Series 2011 Bonds, however, is included as an adjustment in the calculation of federal corporate alternative minimum taxable income and may, therefore, affect a corporation's alternative minimum tax liability. We express no opinion as to any other federal income tax consequences caused by ownership of or receipt of interest on the Bonds.

We are also of the opinion that, under the laws of the State of Hawaii, as presently enacted and construed, interest on the Series 2011 Bonds is exempt from all taxation imposed by the State of Hawaii or any county or other political subdivision thereof, except inheritance, transfer and estate taxes and the franchise tax imposed on banks and other financial institutions, pursuant to Chapter 241 of Title 14 of the Hawaii Revised Statutes. No opinion is expressed regarding taxation of interest on the Series 2011 Bonds under any other provision of Hawaii law. Ownership of the Series 2011 Bonds may result in other Hawaii tax consequences to certain taxpayers, and we express no opinion regarding such collateral tax consequences arising with respect to the Series 2011 Bonds.

The Code contains other provisions that could result in tax consequences as to which we express no opinion, as a result of ownership of the Series 2011 Bonds. Further, certain requirements and procedures contained or referred to in the Certificate, the Tax Certificate, and other documents pertaining to the Series 2011 Bonds, may be changed, and certain actions may be taken or not taken under the circumstances and subject to the terms and conditions set forth in such documents with the approval of counsel nationally recognized in the area of state and local obligations. No opinion is expressed herein as to the effect on the exclusion from gross income of interest on the Series 2011 Bonds for federal income tax purposes of any change to the aforementioned requirements and procedures or of any action taken or not taken after the date of this opinion without our approval. Other than as described herein, we have not addressed and we are not opining on, the tax consequences to any person of the investment in, or receipt of interest on, the Series 2011 Bonds.

With respect to the opinions expressed herein, the rights and obligations under the Series 2011 Bonds, the Certificate and the Tax Certificate are subject to bankruptcy, insolvency, reorganization, arrangement, moratorium and other laws affecting the enforcement of creditors' rights generally, to the application of equitable principles (regardless of whether such enforceability is considered in equity or at law), to the exercise of judicial discretion in appropriate cases and to the limitations on legal remedies against the State of Hawaii. In addition, we express no opinion with respect to any indemnification, contribution, penalty, choice of forum, or waiver provisions contained in the foregoing documents. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the Series 2011 Bonds and express no opinion with respect thereto.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions. Such opinions may be adversely affected by actions taken or events occurring, including a change in law, regulation or ruling (or in the application or official interpretation of any law, regulation or ruling) after the date hereof. We have not undertaken to determine, or to inform any person, whether such actions are taken or such events occur, and we have no obligation to update this opinion in light of such actions or events or for any other reason.

Very truly yours,

PROPOSED FORM OF CONTINUING DISCLOSURE CERTIFICATE

This Continuing Disclosure Certificate (the “Disclosure Certificate”) is executed and delivered by the State of Hawaii (the “State”), acting by and through the State Director of Transportation, in connection with the issuance of \$117,365,000 State of Hawaii Highway Revenue Bonds, Series 2011 A and 2011 B (the “Bonds”). The Bonds are being issued pursuant to the authority of the Constitution and laws of the State, including, in particular, certain acts of the Legislature of the State and that certain Certificate of the Director of Transportation Providing for the issuance of State of Hawaii Highway Revenue Bonds, dated as of August 1, 1993, as supplemented and amended by the Ninth Supplemental Certificate of the Director of Transportation Authorizing State of Hawaii Highway Revenue Bonds, Series 2011 A and Series 2011 B, dated as of December 1, 2011 (collectively, the “Certificate”).

Pursuant to Section 6.04 of the Ninth Supplemental Certificate, the State, acting by and through its Director of Transportation, covenants and agrees as follows:

Section 1. ***Purpose of the Disclosure Certificate.*** This Disclosure Certificate is being executed and delivered by the State for the benefit of the Bondholders and Beneficial Owners of the Bonds and in order to assist the Participating Underwriters in complying with the Rule (as defined below). The State is the only “obligated person” (as defined in the Rule) for the Bonds.

Section 2. ***Definitions.*** In addition to the definitions set forth in the Certificate, which apply to any capitalized term used in this Disclosure Certificate unless otherwise defined in this Section, the following capitalized terms shall have the following meanings:

“*Annual Report*” means any Annual Report provided by the State pursuant to, and as described in, Sections 3 and 4 of this Disclosure Certificate.

“*Beneficial Owner*” means any person which (a) has or shares the power, directly or indirectly, to vote or consent with respect to, to make investment decisions concerning the ownership of, or to dispose of ownership of, any Bonds (including persons holding Bonds through nominees, depositories or other intermediaries), or (b) is treated as the owner of any Bonds for federal income tax purposes.

“*Dissemination Agent*” means the Director of Transportation, or any successor Dissemination Agent designated in writing by the Director of Transportation and which has filed with the Director of Transportation a written acceptance of such designation.

“*Division*” means the Highways Division of the State Department of Transportation.

“*Listed Events*” means any of the events listed in Section 5(a) or (b) of this Disclosure Certificate.

“*MSRB*” means the Municipal Securities Rulemaking Board or any other entity designated or authorized by the Securities and Exchange Commission to receive reports pursuant to the Rule. Until otherwise designated by the MSRB or the Securities and Exchange Commission, filings with the MSRB are to be made through the Electronic Municipal Market Access (EMMA) website of the MSRB, currently located at <http://emma.msrb.org>.

“*Official Statement*” shall mean the Official Statement, dated November 30, 2011, prepared and distributed in connection with the initial sale of the Bonds.

“*Participating Underwriters*” means any of the original underwriters of the Bonds required to comply with the Rule in connection with the offering of the Bonds.

“*Rule*” means Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

Section 3. ***Provision of Annual Reports.***

(a) The State shall, or shall cause the Dissemination Agent to, not later than the first day of the tenth month after the end of each fiscal year (or the next succeeding business day if that day is not a business day) of the State (presently June 30), commencing with the report for the fiscal year ending June 30, 2011, provide to the MSRB an Annual Report that is consistent with the requirements of Section 4 of this Disclosure Certificate. The Annual Report must be submitted in electronic format, accompanied by such identifying information as is prescribed by the MSRB, and may cross-reference other information as provided in Section 4 of this Disclosure Certificate. If the State's fiscal year changes, the State, upon becoming aware of such change, shall give notice of such change in the same manner as for a Listed Event under Section 5(e).

(b) In a timely manner prior to the date set forth in subsection (a) above, the State shall provide the Annual Report to the Dissemination Agent (if other than the State). If the State is unable to provide to the MSRB an Annual Report by the date required in subsection (a), the State shall send a notice to the MSRB in substantially the form attached as Exhibit A. The audited financial statements of the Division may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date.

(c) The Dissemination Agent shall (if the Dissemination Agent is other than the State) file a report with the State certifying that the Annual Report has been provided pursuant to this Disclosure Certificate, stating the date it was provided to the MSRB.

Section 4. ***Content of Annual Reports.***

(a) The Annual Report shall contain or incorporate by reference the following information:

(i) Audited financial statements of the Division for the prior fiscal year, prepared in accordance with generally accepted accounting principles as promulgated to apply to governmental entities from time to time by the Governmental Accounting Standards Board. If the Division's audited financial statements are not available by the time the Annual Report is required to be provided to the MSRB pursuant to Section 3(a), the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the Official Statement relating to the Bonds, and the audited financial statements shall be provided to the MSRB in the same manner as the Annual Report when they become available;

(ii) Budgeted revenues and expenditures of the Division for the current fiscal year; and

(iii) To the extent not provided in the audited financial statements, historical information of the type set forth under the subheadings "REVENUE SOURCES—Historical Revenues" and "DEBT SERVICE COVERAGE—Debt Service Requirements for the Bonds" (where there is a change other than from scheduled principal maturities) in the front part of the Official Statement, and "INFORMATION RELATING TO REVENUE SOURCES" in Appendix B to the Official Statement.

(b) Information contained in an Annual Report for any fiscal year containing any modified operating data or financial information for such fiscal year shall explain, in narrative form, the reasons for such modification and the effect of such modification on the Annual Report being provided for such fiscal year. If a change in accounting principles is included in any such modification, such Annual Report shall present a comparison between the financial statements or information prepared on the basis of modified accounting principles and those prepared on the basis of former accounting principles.

Any or all of the items above may be included by specific reference to other documents, including official statements of debt issues of the State or related public entities, which have been made available to the public on the MSRB's website. The State shall clearly identify each such other document so included by reference.

Section 5. ***Reporting of Significant Events.***

(a) Pursuant to the provisions of this Section 5, the State shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds:

- i. Principal and interest payment delinquencies;
- ii. Unscheduled draws on debt service reserves reflecting financial difficulties;
- iii. Unscheduled draws on credit enhancements reflecting financial difficulties;
- iv. Substitution of credit or liquidity providers, or their failure to perform;
- v. Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determination of taxability or of a Notice of Proposed Issue (IRS Form 5701 TEB);
- vi. Tender offers;
- vii. Defeasances;
- viii. Rating changes; or
- ix. Bankruptcy, insolvency, receivership or similar event of the obligated person.

For the purposes of the event identified in subparagraph (ix) above, the event is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent or similar officer for an obligated person in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the obligated person, or if such jurisdiction has been assumed by leaving the existing governmental body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the obligated person.

(b) The State shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds, if material, not later than ten business days after the occurrence of the event:

- i. Unless described in paragraph 5(a)(v), material notices or determinations by the Internal Revenue Service with respect to the tax status of the Bonds or other material events affecting the tax status of the Bonds;
- ii. Modifications to rights of Bondholders;
- iii. Optional, unscheduled or contingent Bond calls;
- iv. Release, substitution, or sale of property securing repayment of the Bonds;
- v. Non-payment related defaults;
- vi. The consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms; or
- vii. Appointment of a successor or additional trustee or the change of name of a trustee.

(c) The State shall give, or cause to be given, in a timely manner, notice of a failure to provide the annual financial information on or before the date specified in Section 3, as provided in Section 3.

(d) Whenever the State obtains knowledge of the occurrence of a Listed Event described in Section 5(b), the State shall determine if such event would be material under applicable federal securities laws.

(e) If the State learns of the occurrence of a Listed Event described in Section 5(a), or determines that knowledge of a Listed Event described in Section 5(b) would be material under applicable federal securities laws, the State shall within ten business days of occurrence file a notice of such occurrence with the MSRB in electronic format, accompanied by such identifying information as is prescribed by the MSRB.

Section 6. ***Termination of Reporting Obligation.*** The State's obligations under this Disclosure Certificate shall terminate upon the maturity, legal defeasance, prior redemption or acceleration of all of the Outstanding Bonds, or if less than all of the Bonds are defeased, with respect to those Bonds. If such termination occurs prior to the final maturity of the Bonds, the State shall give notice of such termination in the same manner as for a Listed Event under Section 5(e).

Section 7. ***Dissemination Agent.*** From time to time, the Director of Finance may appoint or engage a Dissemination Agent to assist the State in carrying out its obligations under this Disclosure Certificate, and may discharge any such Agent, with or without appointing a successor Dissemination Agent. If at any time there is not any other designated Dissemination Agent, the State shall be the Dissemination Agent. The initial Dissemination Agent shall be the Director of Transportation. The sole remedy of any party against the Dissemination Agent shall be nonmonetary and specific performance. The Dissemination Agent shall not be responsible for the form or content of any Annual Report, notice of Listed Event, or other document furnished to the Dissemination Agent by the State. The Dissemination Agent shall receive reasonable compensation for its services provided hereunder. The Dissemination Agent may resign at any time by providing at least 60 days' notice to the State.

Section 8. ***Amendment Waiver.*** Notwithstanding any other provision of this Disclosure Certificate, the State may amend this Disclosure Certificate, and any provision of this Disclosure Certificate may be waived, provided that all of the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions of Sections 3(a), 4, 5(a), (b), (c) or (e), or 8(a), it may only be made in connection with a change in circumstances that arises from a change in legal (including regulatory) requirements, change in law (including rules or regulations), or change in the identity, nature or status of an obligated person with respect to the Bonds, or the type of business conducted;

(b) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel selected by the State, have complied with the requirements of the Rule at the time of the original issuance of the Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver either (i) is approved by the Holders of the Bonds in the same manner as provided in the Certificate for amendments to the Certificate with the consent of Holders of the Bonds, or (ii) does not, in the opinion of nationally recognized bond counsel selected by the State, materially impair the interests of the Holders or Beneficial Owners of the Bonds.

In the event of any amendment or waiver of a provision of this Disclosure Certificate, the State shall describe such amendment in the next Annual Report, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the State. In addition, if the amendment relates to the accounting principles to be followed in preparing financial statements, (i) notice of such change shall be given in the same manner as for a Listed Event under Section 5(e), and (ii) the Annual Report for the year in which the change is made should present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

Section 9. ***Additional Information.*** Nothing in this Disclosure Certificate shall be deemed to prevent the State from disseminating any other information, using the means of dissemination set forth in this Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Certificate. If the State chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Certificate, the State shall have no obligation under this Disclosure Certificate to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

Nothing in this Disclosure Certificate shall be deemed to prevent the State from supplementing this Disclosure Certificate to provide that it shall also govern continuing disclosure for one or more issues of Additional Bonds (as defined in the Certificate).

Section 10. ***Failure to Perform.*** (a) The agreements of the State set forth in Sections 3 and 4 of this Disclosure Certificate are intended to be for the benefit solely of the Bondholders and Beneficial Owners from time to time of the Bonds.

The sole remedy for any breach of this Disclosure Certificate by the State shall be limited, as hereinafter described, to a right of Bondholders and Beneficial Owners to cause proceedings at law or in equity to be instituted and maintained to obtain mandamus or specific performance by the State of its obligations hereunder. Any individual Bondholder or Beneficial Owner may institute and maintain, or cause to be instituted and maintained, such proceedings to require the State to provide or cause to be provided a pertinent filing if such a filing is due and has not been made. Any such proceedings challenging the adequacy of the information provided in accordance with this Disclosure Certificate may be instituted and maintained only by the Bondholders and the Beneficial Owners of not less than 25% in principal amount of the Bonds then outstanding or their agent.

(b) Any failure of the State to comply with any provisions of this Disclosure Certificate shall not be a default or an event of default with respect to the Bonds under the Certificate.

Section 11. ***Beneficiaries.*** This Disclosure Certificate shall inure solely to the benefit of the State, the Dissemination Agent, the Participating Underwriters and the Bondholders and Beneficial Owners from time to time of the Bonds and shall create no rights in any other person or entity.

Section 12. ***Recordkeeping.*** The Director of Finance shall maintain records of all Annual Information and notice of material Listed Events including the content of such disclosure, the names of the entities with whom such disclosures were filed and the date of filing such disclosure.

Section 13. ***Governing Law.*** This Disclosure Certificate shall be governed by the laws of the State.

Date: December 15, 2011

STATE OF HAWAII

By: _____
Glenn Okimoto
Director, Department of Transportation

EXHIBIT A

**FORM OF NOTICE TO THE MUNICIPAL SECURITIES RULEMAKING BOARD OF FAILURE
TO FILE ANNUAL REPORT**

Name of Issuer: State of Hawaii

Name of Bond Issue: Highway Revenue Bonds, Series 2011 A and 2011 B

Date of Issuance: December 15, 2011

NOTICE IS HEREBY GIVEN that the State of Hawaii (the "State") has not provided an Annual Report with respect to the above-named Bonds as required by Section 3 of the Continuing Disclosure Certificate, dated December 15, 2011, executed by the State for the benefit of the holders and beneficial owners of the above-referenced Bonds. The State anticipates that the Annual Report will be filed by _____.

Dated: _____

STATE OF HAWAII

By: _____
 Authorized Signatory

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may be instituted and maintained only by Holders and beneficial owners of not less than 25% in principal amount of the Series 2011 Bonds then Outstanding.

FINANCIAL STATEMENTS

The audited financial statements of the Highways Division as of and for the fiscal year ended June 30, 2010 are set forth in Appendix D to this Official Statement. These financial statements have been audited by KMH LLP, Honolulu, Hawaii, independent certified public accountants, whose report is set forth in Appendix D.

CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING STATEMENTS

Certain statements included or incorporated by reference in this Official Statement constitute "forward-looking statements." Such statements are generally identifiable by the terminology used such as "plan," "expect," "estimate," "budget" or similar words. Such forward-looking statements include, among others, statements found under "DEBT SERVICE COVERAGE—Projected Revenues," "ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES, THE STATE HIGHWAY SYSTEM AND THE DEPARTMENT OF TRANSPORTATION" in Appendix B, and "GENERAL INFORMATION ABOUT THE STATE OF HAWAII" in Appendix C.

THE ACHIEVEMENT OF CERTAIN RESULTS OR OTHER EXPECTATIONS CONTAINED IN SUCH FORWARD-LOOKING STATEMENTS INVOLVES KNOWN AND UNKNOWN RISKS, UNCERTAINTIES AND OTHER FACTORS, WHICH MAY CAUSE ACTUAL RESULTS, PERFORMANCE OR ACHIEVEMENTS DESCRIBED TO BE MATERIALLY DIFFERENT FROM ANY FUTURE RESULTS, PERFORMANCE OR ACHIEVEMENTS EXPRESSED OR IMPLIED BY SUCH FORWARD-LOOKING STATEMENTS. THE STATE DOES NOT PLAN TO ISSUE ANY UPDATES OR REVISIONS TO THOSE FORWARD-LOOKING STATEMENTS IF OR WHEN CHANGES OCCUR TO ITS EXPECTATIONS, OR EVENTS, CONDITIONS OR CIRCUMSTANCES ON WHICH SUCH STATEMENTS ARE BASED.

MISCELLANEOUS

The references in this Official Statement to Acts of the Legislature and the Certificate (including the supplements thereto) do not purport to be complete and are subject to the detailed provisions thereof to which reference is hereby made. The Acts and other Hawaii statutes may be amended by the Legislature. The Department has provided the information in this Official Statement relating to the Highways Division, and other matters, as indicated.

All statements in this Official Statement involving matters of opinion, estimates, forecasts, projections, or the like, whether or not expressly so stated, are intended as such and not as representations of fact. No representation is made that any such statements will be realized. The agreements of the Department and the State are fully set forth in the Certificate and the General Revenue Bond Law, and the Official Statement is not to be construed as a contract or agreement between the Department or the State and the purchasers or Holders of any of the Series 2011 Bonds.

DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII



/s/ Glenn Okimoto

By: Glenn Okimoto, Director of Transportation